



**OPERATION SMILE, INC.  
AND AFFILIATE**

Combined Financial Statements and Schedules

June 30, 2011 and 2010

(With Independent Auditors' Report Thereon)

**OPERATION SMILE, INC.  
AND AFFILIATE**

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KPMG LLP  
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## 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 Company) as of June 30, 2011 and 2010, 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 Company'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 Company'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, 2011 and 2010, and the results of their activities and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

Our audits were made for the purpose of forming an opinion on the basic combined financial statements taken as a whole. The combining information in schedules 1 and 2 is presented for purposes of additional analysis of the combined financial statements rather than to present the financial position and results of operations of the individual companies. The combining information referred to in this report has been subjected to the auditing procedures applied in the audits of the basic combined financial statements and, in our opinion, is fairly stated in all material respects in relation to the combined financial statements taken as a whole.

**KPMG LLP**

November 10, 2011

**OPERATION SMILE, INC.  
AND AFFILIATE**

Combined Statements of Financial Position

June 30, 2011 and 2010

<b>Assets</b>	<b>2011</b>	<b>2010</b>
Cash	\$ 5,084,731	8,080,818
Investments (note 3)	5,506,217	5,346,036
Prepaid expenses	1,171,529	90,707
Mission advances and other receivables	571,929	349,574
Contributions receivable, net (note 2)	5,540,385	3,461,969
Inventories	6,731,518	6,548,582
Property and equipment, net (notes 4 and 6)	<u>6,072,224</u>	<u>1,514,624</u>
Total assets	<u>\$ 30,678,533</u>	<u>25,392,310</u>
<b>Liabilities and Net Assets</b>		
Accounts payable and accrued expenses	\$ 4,891,210	4,786,431
Deferred revenue	837,675	151,558
Capital lease payable (notes 4 and 6)	<u>45,947</u>	<u>32,961</u>
Total liabilities	5,774,832	4,970,950
Net assets:		
Unrestricted	16,475,827	16,057,621
Temporarily restricted (note 7)	<u>8,427,874</u>	<u>4,363,739</u>
Total net assets	24,903,701	20,421,360
Commitments and contingencies (note 6)		
Total liabilities and net assets	<u>\$ 30,678,533</u>	<u>25,392,310</u>

See accompanying notes to combined financial statements.

**OPERATION SMILE, INC.  
AND AFFILIATE**

Combined Statements of Activities  
Years ended June 30, 2011 and 2010

	<b>2011</b>			<b>2010</b>		
	<b>Unrestricted net assets</b>	<b>Temporarily restricted net assets</b>	<b>Total</b>	<b>Unrestricted net assets</b>	<b>Temporarily restricted net assets</b>	<b>Total</b>
<b>Revenues:</b>						
Contributions (note 10)	\$ 32,133,949	8,753,615	40,887,564	28,095,126	5,462,686	33,557,812
Gifts-in-kind (note 5)	3,104,913	3,050,000	6,154,913	6,533,456	—	6,533,456
Contributed services (note 5)	25,140,416	—	25,140,416	26,380,670	—	26,380,670
Program service revenue	858,386	—	858,386	476,362	—	476,362
Other income, net	66,925	—	66,925	7,386	—	7,386
Net assets released from restrictions (note 8)	7,739,480	(7,739,480)	—	4,894,674	(4,894,674)	—
Total revenues	<u>69,044,069</u>	<u>4,064,135</u>	<u>73,108,204</u>	<u>66,387,674</u>	<u>568,012</u>	<u>66,955,686</u>
<b>Expenses:</b>						
Program services (note 5):						
Medical missions	37,624,927	—	37,624,927	39,870,437	—	39,870,437
Education and sustainability	12,366,934	—	12,366,934	7,358,021	—	7,358,021
Total program services	<u>49,991,861</u>	<u>—</u>	<u>49,991,861</u>	<u>47,228,458</u>	<u>—</u>	<u>47,228,458</u>
Supporting services:						
Fund-raising	15,872,232	—	15,872,232	15,762,851	—	15,762,851
Administration	2,761,770	—	2,761,770	1,565,424	—	1,565,424
Total supporting services	<u>18,634,002</u>	<u>—</u>	<u>18,634,002</u>	<u>17,328,275</u>	<u>—</u>	<u>17,328,275</u>
Total expenses	<u>68,625,863</u>	<u>—</u>	<u>68,625,863</u>	<u>64,556,733</u>	<u>—</u>	<u>64,556,733</u>
Change in net assets	418,206	4,064,135	4,482,341	1,830,941	568,012	2,398,953
Net assets at beginning of year	<u>16,057,621</u>	<u>4,363,739</u>	<u>20,421,360</u>	<u>14,226,680</u>	<u>3,795,727</u>	<u>18,022,407</u>
Net assets at end of year	<u>\$ 16,475,827</u>	<u>8,427,874</u>	<u>24,903,701</u>	<u>16,057,621</u>	<u>4,363,739</u>	<u>20,421,360</u>

See accompanying notes to combined financial statements.

**OPERATION SMILE, INC.  
AND AFFILIATE**

Combined Statements of Cash Flows

Years ended June 30, 2011 and 2010

	<b>2011</b>	<b>2010</b>
Cash flows from operating activities:		
Change in net assets	\$ 4,482,341	2,398,953
Adjustments to reconcile change in net assets to net cash (used in) provided by operating activities:		
Depreciation expense	370,616	400,439
Equipment donation to program countries	139,517	—
Net realized and unrealized losses on investments	(22,969)	(6,300)
In-kind donation of land	(3,050,000)	—
In-kind donations of supplies and inventory	(121,787)	(2,615,578)
Investment contributions received	(150,157)	(196,348)
Changes in operating assets and liabilities:		
Prepaid expenses	(1,080,822)	(31,267)
Mission advances and other receivables	(221,123)	(156,385)
Contributions receivable	(2,085,816)	(847,015)
Inventories	(53,749)	360,609
Accounts payable and accrued expenses	106,473	1,826,040
Deferred revenue	686,117	151,558
Net cash (used in) provided by operating activities	(1,001,359)	1,284,706
Cash flows from investing activities:		
Purchases of property and equipment	(2,018,132)	(391,212)
Purchases of investments	(27,053)	(31,705)
Proceeds from sales and maturities of investments	36,364	8,000
Net cash used in investing activities	(2,008,821)	(414,917)
Cash flows used in financing activities:		
Net borrowings (repayments) on capital leases	12,986	(21,412)
Effect of exchange rate changes on cash	1,107	199
Net (decrease) increase in cash	(2,996,087)	848,576
Cash at beginning of year	8,080,818	7,232,242
Cash at end of year	\$ 5,084,731	8,080,818
Supplemental cash flow information:		
Cash paid for interest	\$ 7,747	12,865

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, 2011 and 2010

	<b>2011</b>						
	<b>Program services</b>			<b>Supporting services</b>			
	<b>Medical missions</b>	<b>Education and sustainability</b>	<b>Total</b>	<b>Fund-raising</b>	<b>Administration</b>	<b>Total</b>	<b>Total expenses</b>
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

  

	<b>2010</b>						
	<b>Program services</b>			<b>Supporting services</b>			
	<b>Medical missions</b>	<b>Education and sustainability</b>	<b>Total</b>	<b>Fund-raising</b>	<b>Administration</b>	<b>Total</b>	<b>Total expenses</b>
Grants	\$ 938,360	1,684,561	2,622,921	—	—	—	2,622,921
Salaries and benefits	1,902,758	1,966,164	3,868,922	2,040,565	628,012	2,668,577	6,537,499
Professional services	495,766	820,751	1,316,517	3,622,760	186,371	3,809,131	5,125,648
Advertising and promotion	144,113	379,215	523,328	294,461	29,619	324,080	847,408
Supplies and equipment	6,091,253	584,152	6,675,405	306,048	233,817	539,865	7,215,270
Occupancy	252,986	78,736	331,722	50,341	24,408	74,749	406,471
Travel and conferences	3,204,704	906,684	4,111,388	196,669	49,338	246,007	4,357,395
Interest	6,236	3,219	9,455	2,421	989	3,410	12,865
Depreciation	232,815	34,885	267,700	39,384	93,355	132,739	400,439
Insurance	47,258	8,085	55,343	9,070	13,223	22,293	77,636
Other mission expense	146,699	—	146,699	—	—	—	146,699
Fundraising	—	—	—	9,178,432	—	9,178,432	9,178,432
Public education and awareness	—	872,310	872,310	—	294,921	294,921	1,167,231
Contributed services	26,380,670	—	26,380,670	—	—	—	26,380,670
Other	26,819	19,259	46,078	22,700	11,371	34,071	80,149
Total expenses	\$ 39,870,437	7,358,021	47,228,458	15,762,851	1,565,424	17,328,275	64,556,733

See accompanying notes to combined financial statements.

**OPERATION SMILE, INC.  
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Notes to Combined Financial Statements

June 30, 2011 and 2010

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

**(a) Nature of Organization**

Operation Smile, Inc., and subsidiary (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. In addition, Operation Smile medical professionals provide education and training programs on the latest surgical techniques. Operation Smile is the only organization authorized by the American Heart Association to function as a mobile, global International Training Organization, providing PALS, ACLS, and 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 international headquarters located in Virginia Beach, Virginia. The City of Virginia Beach donated the land for the project (note 5). A groundbreaking was held in September 2010 with construction expected to be completed by Fall 2012. In July 2011, a donor pledged \$10,000,000 and Operation Smile received financing through a bank to complete the project. The bank loan is a nonrevolving construction line of credit up to \$10,000,000. Interest only is payable at 5.5% for the first 36 months, followed by 47 consecutive, monthly installments of principal and interest based on a 20-year amortization at the then-current interest rate. All outstanding principal and interest are due in July 2018.

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 fund-raising 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 sixteen 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. These international foundations also raise funds and awareness to support its 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.



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Notes to Combined Financial Statements

June 30, 2011 and 2010

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, 2011 and 2010.

**(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 and land, which is 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. Work in process is stated at cost. No provision for depreciation is made on 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

**OPERATION SMILE, INC.  
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Notes to Combined Financial Statements

June 30, 2011 and 2010

depreciation expense for the years ended June 30, 2011 and 2010 was \$370,616 and \$400,439, 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, 2011 or 2010.

**(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 purpose. Expenses related to certain events, donor communication and program materials jointly support medical missions, education and sustainability, fund-raising, and administration and were allocated by their function classification as follows for the years ended June 30, 2011 and 2010:

	<u>2011</u>	<u>2010</u>
Medical missions	\$ 40,044	81,176
Education and sustainability	5,962,253	1,036,581
Fund-raising	8,181,236	4,022,239
Administration	441,451	391,073
Total joint costs	<u>\$ 14,624,984</u>	<u>5,531,069</u>

**OPERATION SMILE, INC.  
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Notes to Combined Financial Statements

June 30, 2011 and 2010

**(n) 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.

**(o) 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, 2011 and 2010, the carrying value of all the investments was considered to be the fair value determined using Level 1 inputs in the fair value hierarchy.

**(p) 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, 2011 and 2010, 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.

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Notes to Combined Financial Statements

June 30, 2011 and 2010

**(q) Subsequent Events**

OSI has evaluated subsequent events from the statement of financial position date through November 10, 2011, the date these combined financial statements were available to be issued, and determined there are no other items to disclose other than the donor pledge and bank financing discussed in note 1(a).

**(2) Contributions Receivable**

Contributions receivable at June 30, 2011 and 2010 are expected to be received as follows:

	<u>2011</u>	<u>2010</u>
Within one year	\$ 3,796,892	1,782,083
From one to five years	<u>1,856,697</u>	<u>1,765,435</u>
	5,653,589	3,547,518
Less discount to present value at rates, which range from 0.74% to 5.62%	<u>113,204</u>	<u>85,549</u>
	<u>\$ 5,540,385</u>	<u>3,461,969</u>

**(3) Investments**

Investments consist of the following at June 30, 2011 and 2010:

	<u>2011</u>	<u>2010</u>
Money market funds	\$ 1,886,242	3,160,790
U.S. Treasury bills	3,501,004	2,098,526
Mutual funds	<u>118,971</u>	<u>86,720</u>
Total investments	<u>\$ 5,506,217</u>	<u>5,346,036</u>

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Notes to Combined Financial Statements

June 30, 2011 and 2010

**(4) Property and Equipment**

Property and equipment consist of the following at June 30, 2011 and 2010:

	<u>2011</u>	<u>2010</u>
Work in process	\$ 1,968,540	247,629
Medical equipment	2,596,118	2,462,949
Furniture, fixtures, and office equipment	1,469,787	1,533,085
Buildings	240,555	240,555
Building improvements	362,448	362,448
Land	3,094,293	—
	<u>9,731,741</u>	<u>4,846,666</u>
Less accumulated depreciation	<u>3,659,517</u>	<u>3,332,042</u>
Property and equipment, net	<u>\$ 6,072,224</u>	<u>1,514,624</u>

As of June 30, 2011 and 2010, furniture, fixtures, and office equipment recorded under capital leases have a cost basis of \$84,317 and \$96,670 and related accumulated amortization of \$38,370 and \$63,709 for a net book value of \$45,947 and \$32,961, 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 \$25,140,416 and \$26,380,670 in 2011 and 2010, 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 \$3,104,913 and \$6,533,456 in 2011 and 2010, 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 \$2,983,126 and \$4,011,802 in 2011 and 2010, respectively.

The City of Virginia Beach, Virginia donated land to OS HQ, LLC to be used for a new international headquarters. 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

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Notes to Combined Financial Statements

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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, 2011.

**(6) Leases**

OSI is obligated under capital and operating leases for its facility and certain equipment. The facility lease is an operating lease and expires in February 2012, but OSI is working to secure a lease extension that will allow it to remain in its current facility until the new headquarters building is completed.

Future minimum lease payments under the operating lease and the present value of future minimum capital lease payments as of June 30, 2011 are as follows:

	<b>Capital lease</b>	<b>Operating lease</b>
Year ending June 30:		
2012	\$ 22,151	127,439
2013	18,317	—
2014	9,797	—
2015	9,797	—
2016	5,531	—
Total minimum lease payments	65,593	\$ 127,439
Less amount representing interest	19,646	
Present value of net minimum lease payments	45,947	
Less current maturities of capital lease obligations	16,646	
Capital lease obligations, excluding current maturities	\$ 29,301	

Total rent expense was \$191,535 and \$185,897 in 2011 and 2010, respectively.

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Notes to Combined Financial Statements

June 30, 2011 and 2010

**(7) Temporarily Restricted Net Assets**

Temporarily restricted net assets consist of the following at June 30, 2011 and 2010:

	<u>2011</u>	<u>2010</u>
Care centers	\$ 211,583	218,531
Disaster relief	—	192,355
Domestic programs	48,878	145,584
Fellowships	—	78,128
Global education and sustainability	162,086	423,657
International programs	873,045	745,090
International headquarters building	—	52,000
Land	3,050,000	—
Research	107,259	—
Other programs	—	120,183
	<u>4,452,851</u>	<u>1,975,528</u>
Total purpose restricted		
	<u>3,975,023</u>	<u>2,388,211</u>
Total time restricted		
Total temporarily restricted net assets	<u>\$ 8,427,874</u>	<u>4,363,739</u>

**(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 \$7,739,480 and \$4,894,674 for the years ended June 30, 2011 and 2010, respectively.

**(9) Retirement Savings Plan**

OSI has a 401(k) retirement savings plan, which covers all employees with six months of service. 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, 2011 and 2010 were \$430,863 and \$367,295, respectively.

**(10) Related-Party Transactions**

OSI received contributions from its Board of Directors and respective committee members of \$113,426 and \$451,976 for the years ended June 30, 2011 and 2010, respectively.

**OPERATION SMILE, INC.  
AND AFFILIATE**

Combining Schedule – Statements of Financial Position

June 30, 2011 and 2010

Assets	2011				2010		
	Operation Smile, Inc.	OS HQ, LLC <sup>1</sup>	Operation Smile Foundation, Inc.	Total	Operation Smile, Inc.	Operation Smile Foundation, Inc.	Total
Cash	\$ 5,080,241	—	4,490	5,084,731	7,947,761	133,057	8,080,818
Investments	5,506,217	—	—	5,506,217	5,346,036	—	5,346,036
Prepaid expenses	1,171,529	—	—	1,171,529	90,707	—	90,707
Mission advances and other receivables	571,929	—	—	571,929	349,574	—	349,574
Contributions receivable, net	4,543,870	996,515	—	5,540,385	3,461,969	—	3,461,969
Inventories	6,731,518	—	—	6,731,518	6,548,582	—	6,548,582
Property and equipment, net	1,153,283	4,918,941	—	6,072,224	1,514,624	—	1,514,624
Due (to) from	618,453	(618,453)	—	—	—	—	—
Total assets	\$ 25,377,040	5,297,003	4,490	30,678,533	25,259,253	133,057	25,392,310
<b>Liabilities and Net Assets</b>							
Accounts payable and accrued expenses	\$ 4,891,203	—	7	4,891,210	4,786,431	—	4,786,431
Deferred revenue	837,675	—	—	837,675	151,558	—	151,558
Capital lease payable	45,947	—	—	45,947	32,961	—	32,961
Total liabilities	5,774,825	—	7	5,774,832	4,970,950	—	4,970,950
Net assets:							
Unrestricted	14,224,341	2,247,003	4,483	16,475,827	15,924,564	133,057	16,057,621
Temporarily restricted	5,377,874	3,050,000	—	8,427,874	4,363,739	—	4,363,739
Total net assets	19,602,215	5,297,003	4,483	24,903,701	20,288,303	133,057	20,421,360
Total liabilities and net assets	\$ 25,377,040	5,297,003	4,490	30,678,533	25,259,253	133,057	25,392,310

<sup>1</sup> OS HQ, LLC is a wholly owned subsidiary of Operation Smile, Inc.

See accompanying independent auditors' report.



**OPERATION SMILE, INC.  
AND AFFILIATE**

Combining Schedule – Statements of Activities

Years ended June 30, 2011 and 2010

	2011				2010		
	Operation Smile, Inc.	OS HQ, LLC <sup>1</sup>	Operation Smile Foundation, Inc.	Combined total	Operation Smile, Inc.	Operation Smile Foundation, Inc.	Combined total
Revenues:							
Contributions	\$ 38,627,484	2,250,080	10,000	40,887,564	33,557,812	—	33,557,812
Gifts-in-kind	3,104,913	3,050,000	—	6,154,913	6,533,456	—	6,533,456
Contributed services	25,140,416	—	—	25,140,416	26,380,670	—	26,380,670
Program service revenue	858,386	—	—	858,386	476,362	—	476,362
Other income, net	66,925	—	—	66,925	7,386	—	7,386
Total revenues	<u>67,798,124</u>	<u>5,300,080</u>	<u>10,000</u>	<u>73,108,204</u>	<u>66,955,686</u>	<u>—</u>	<u>66,955,686</u>
Expenses:							
Program services:							
Medical missions	37,632,416	—	—	37,632,416	39,870,437	—	39,870,437
Education and sustainability	12,605,941	—	—	12,605,941	7,358,021	—	7,358,021
Total program services	<u>50,238,357</u>	<u>—</u>	<u>—</u>	<u>50,238,357</u>	<u>47,228,458</u>	<u>—</u>	<u>47,228,458</u>
Supporting services:							
Fund-raising	15,359,768	—	138,574	15,498,342	15,759,894	2,957	15,762,851
Administration	2,886,087	3,077	—	2,889,164	1,565,424	—	1,565,424
Total supporting services	<u>18,245,855</u>	<u>3,077</u>	<u>138,574</u>	<u>18,387,506</u>	<u>17,325,318</u>	<u>2,957</u>	<u>17,328,275</u>
Total expenses	<u>68,484,212</u>	<u>3,077</u>	<u>138,574</u>	<u>68,625,863</u>	<u>64,553,776</u>	<u>2,957</u>	<u>64,556,733</u>
Change in net assets	(686,088)	5,297,003	(128,574)	4,482,341	2,401,910	(2,957)	2,398,953
Net assets at beginning of year	20,288,303	—	133,057	20,421,360	17,886,393	136,014	18,022,407
Net assets at end of year	<u>\$ 19,602,215</u>	<u>5,297,003</u>	<u>4,483</u>	<u>24,903,701</u>	<u>20,288,303</u>	<u>133,057</u>	<u>20,421,360</u>

<sup>1</sup> OS HQ, LLC is a wholly owned subsidiary of Operation Smile, Inc.

See accompanying independent auditors' report.