



Consolidated Financial Statements and Report of
Independent Certified Public Accountants

United Service Organizations, Inc.

December 31, 2013

United Service Organizations, Inc.

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Report On the Financial Statements

We have audited the accompanying consolidated financial statements of United Service Organizations, Inc. (USO), which comprise the consolidated statement of financial position as of December 31, 2013, and the related consolidated statements of activities and changes in net assets and cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated 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 consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the USO's preparation and fair presentation of the consolidated 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 USO'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 consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of United Service Organizations, Inc. as of December 31, 2013, and the changes in their net assets and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidated schedule of functional expenses for the year ended December 31, 2013 is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures. These additional procedures included comparing and reconciling the information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Report On 2012 Summarized Comparative Information

We have previously audited the USO's 2012 consolidated financial statements (not presented herein), and we expressed an unmodified audit opinion on those audited consolidated financial statements in our report dated March 27, 2013. In our opinion, the accompanying summarized comparative information as of and for the year ended December 31, 2012 is consistent, in all material respects, with the audited financial statements from which it has been derived.

Other Reporting Required By Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report, dated March 27, 2013, on our consideration of USO's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering USO's internal control over financial reporting and compliance.



McLean, Virginia
March 26, 2014

United Service Organizations, Inc.

Consolidated Statements of Financial Position

<i>December 31,</i>	2013	2012
<i>Assets</i>		
Cash and cash equivalents	\$ 22,976,575	\$ 23,829,589
Contributions receivable, net	18,287,313	13,916,277
Grants receivable	5,149,764	3,497,407
Other receivables, net	617,946	292,544
Prepaid expenses and other assets	2,180,393	1,907,133
Inventory	4,316,807	5,296,866
Investments	78,175,963	71,692,402
Programmatic investments	5,950,000	1,815,137
Fixed assets, net	6,842,017	7,759,666
Total Assets	\$ 144,496,778	\$ 130,007,021
<i>Liabilities and Net Assets</i>		
<i>Liabilities</i>		
Accounts payable and accrued expenses	\$ 10,111,459	\$ 11,833,915
Deferred rent	367,288	471,852
Total Liabilities	10,478,747	12,305,767
<i>Net Assets</i>		
Unrestricted		
Operating	43,275,455	31,560,796
Board-designated		
Spirit of Hope	35,656,381	32,517,371
Total unrestricted	78,931,836	64,078,167
Temporarily restricted		
Desert Storm Education Fund	647,613	615,300
Spirit of Hope	16,571,470	12,863,002
Ongoing Program Activities	7,381,875	8,020,809
USO Warrior and Family Care	4,247,787	5,730,088
USO Centers and Councils	639,527	795,965
Total temporarily restricted	29,488,272	28,025,164
Permanently restricted		
Camp Casey	25,000	25,000
Spirit of Hope	25,572,923	25,572,923
Total permanently restricted	25,597,923	25,597,923
Total Net Assets	134,018,031	117,701,254
Total Liabilities and Net Assets	\$ 144,496,778	\$ 130,007,021

The accompanying notes are an integral part of these statements.

United Service Organizations, Inc.

Consolidated Statement of Activities and Changes in Net Assets

Year ended December 31, 2013 (with summarized comparative totals for the year ended December 31, 2012)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total 2013	Total 2012
Revenue and Support					
Contributions:					
Corporate, foundation and individual giving	\$ 20,991,494	\$ 14,856,337	\$ —	\$ 35,847,831	\$ 30,316,628
Direct response	70,009,137	571,133	—	70,580,270	65,205,612
United way and CFC	1,718,856	—	—	1,718,856	1,875,369
Contributed materials, facilities and services	74,105,447	1,700,747	—	75,806,194	136,938,338
Grants	17,991,734	—	—	17,991,734	18,397,662
USO center revenue	6,483,510	—	—	6,483,510	6,302,264
Investment income	3,138,647	3,760,388	—	6,899,035	6,367,757
Other income	104,099	—	—	104,099	86,702
Total Revenue and Support	194,542,924	20,888,605	—	215,431,529	265,490,332
Net Assets Released from Restrictions	19,425,497	(19,425,497)	—	—	—
Total Revenue and Other Support	213,968,421	1,463,108	—	215,431,529	265,490,332
Operating Expenses					
Program services:					
USO centers	42,004,308	—	—	42,004,308	43,524,301
Programs	13,306,358	—	—	13,306,358	13,407,678
Contributed materials, facilities and services	76,006,910	—	—	76,006,910	137,879,064
Entertainment	9,122,619	—	—	9,122,619	8,831,137
Communications and public awareness outreach	18,307,634	—	—	18,307,634	16,400,240
Total program expenses	158,747,829	—	—	158,747,829	220,042,420
Supporting Services					
Fundraising	24,064,579	—	—	24,064,579	20,911,693
Management and general	16,302,344	—	—	16,302,344	14,122,352
Total Supporting Services	40,366,923	—	—	40,366,923	35,034,045
Total Operating Expenses	199,114,752	—	—	199,114,752	255,076,465
Changes in Net Assets	14,853,669	1,463,108	—	16,316,777	10,413,867
Net Assets, beginning of year	64,078,167	28,025,164	25,597,923	117,701,254	107,287,387
Net Assets, end of year	\$ 78,931,836	\$ 29,488,272	\$ 25,597,923	\$ 134,018,031	\$ 117,701,254

The accompanying notes are an integral part of this statement.

United Service Organizations, Inc.

Consolidated Statements of Cash Flows

<i>Years ended December 31,</i>	2013	2012
Cash Flows from Operating Activities		
Change in net assets	\$ 16,316,777	\$ 10,413,867
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	2,519,847	2,521,752
Contributed investments	(230,822)	(688,319)
Change in discount and allowance on contributions receivable, net	(89,194)	125,449
Realized/unrealized gain on investments	(5,056,847)	(4,793,481)
Revenue from contributed inventory, construction materials, equipment	(2,041,104)	(2,341,437)
Contributed inventory used	2,519,409	3,349,523
(Gain) loss on disposal of fixed assets	(2,409)	14,617
Changes in assets and liabilities:		
Programmatic investments	(3,299,423)	459,954
Contributions receivable	(4,052,117)	(934,850)
Grants and other receivables	(1,703,738)	(2,017,528)
Prepaid expenses and other assets	(273,260)	(413,002)
Inventory	(48,381)	(740,573)
Accounts payable and accrued expenses	(2,557,896)	4,254,548
Deferred rent	(104,564)	(99,495)
Net Cash Provided by Operating Activities	1,896,278	9,111,025
Cash Flows from Investing Activities		
Purchase of fixed assets	(1,283,606)	(1,817,077)
Proceeds from the sale of fixed assets	4,227	—
Purchase of investments	(23,018,525)	(22,243,701)
Sales of investments	21,548,612	21,308,941
Net Cash Used in Investing Activities	(2,749,292)	(2,751,837)
Net (Decrease) Increase in Cash and Cash Equivalents	(853,014)	6,359,188
Cash and Cash Equivalents, beginning of year	23,829,589	17,470,401
Cash and Cash Equivalents, end of year	\$ 22,976,575	\$ 23,829,589

The accompanying notes are an integral part of these statements.

United Service Organizations, Inc.

Notes to Consolidated Financial Statements

December 31, 2013 and 2012

NOTE A—ORGANIZATION

United Service Organizations, Inc. (USO) is a not-for-profit, congressionally chartered, private organization devoted exclusively to lifting the spirits of America's troops and their families. The USO is not part of the United States Government, but is recognized by the Department of Defense, Congress and President of the United States, who serves as Honorary Chairman of USO. The USO relies on the generosity of individuals, organizations and corporations to support its activities. For over seventy years its mission has been to enhance the quality of life for military personnel and their families by helping them adjust to the special rigors of a transient military lifestyle and by fostering a partnership between the military and civilian communities. To carry out its mission, the USO provides a touch of home through Centers at airports and military installations around the world, free celebrity entertainment tours, and innovative programs and services for troops and their families to meet their ever-changing needs. The USO also provides critical support to those who need us most, including forward deployed troops, military families, wounded warriors and families of the fallen.

NOTE B—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying consolidated financial statements reflect the accounts of USO Arlington, the USO Foundation, and its domestic and overseas operating centers. All intercompany accounts and transactions have been eliminated.

Chartered stateside USO affiliates are financially autonomous of the USO and are, therefore, excluded from the USO's consolidated financial statements.

Use of Estimates

The presentation of consolidated financial statements in accordance with accounting principles generally accepted in the United States of America 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 consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

United Service Organizations, Inc.

Notes to Consolidated Financial Statements—Continued

December 31, 2013 and 2012

NOTE B—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

Net Assets

Net assets, which are composed of unrestricted, temporarily and permanently restricted funds, are described below:

Unrestricted Funds:

- *Operating*—Funds that are generated from general activities and are used to support day-to-day programs and operations.
- *Spirit of Hope*—Funds which have been designated by the Board of Governors to assist the USO in delivering its programs and services for many years into the future. These Board designated contributions and investment earnings are available to fund operations. The fund was established in 1998 with a transfer of funds from the Desert Storm Education Fund. In the event that the Desert Storm Education Fund does not have sufficient resources to meet its obligations as originally intended, the funds transferred from the Desert Storm Education Fund to the Spirit of Hope shall be available to satisfy any such remaining obligations.

Temporarily Restricted Funds:

- *Desert Storm Education Fund*—Contributions restricted to provide for academic or vocational scholarships to surviving family members of casualties of Desert Shield/Storm operations. On December 31, 2020, the fund shall be terminated and any funds remaining shall be transferred to the Spirit of Hope Endowment and held in perpetuity for the benefit of the USO.
- *Ongoing Program Activities*—Contributions restricted for various worldwide USO programs, such as USO Operation Phone Home, USO2GO, United Through Reading's Military Program, Trevor Romain and other programming.
- *USO Warrior and Family Care*—Contributions restricted for the establishment and operations of USO Warrior and Family Centers and programs that supports the continuum of care for wounded, ill or injured warriors. As of December 31, 2013 and 2012, this category of temporarily restricted net assets included both time restricted and program restricted contributions.
- *USO Centers and Councils*—Donor funds restricted for use in certain USO Centers and regional localities.
- *Spirit of Hope*—Earnings on donor-restricted endowment funds classified as temporarily restricted net assets until those amounts are appropriated for expenditure.

December 31, 2013 and 2012

NOTE B—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

Permanently Restricted Funds:

- *Camp Casey Endowment*—A contribution which has been restricted by the donor to be held in perpetuity, with stipulations on a portion of the earnings to be used for Camp Casey and the remaining to be used for on-going programs and services.
- *Spirit of Hope Endowment Fund*—Funds to be held in perpetuity, with the earnings available to assist the USO in delivering its programs and services for many years into the future. These contributions are from Congressional appropriations and from corporate and individual contributions.

Foreign Currency

The USO operates Centers at military installations around the world. The United States dollar is the functional currency of the USO; however, the USO maintains financial assets and liabilities in foreign currencies to meet the local obligations of the Centers. The financial assets and liabilities in foreign currencies are translated using exchange rates in effect at the end of the period and revenue and costs are translated using weighted average exchange rates for the period.

Cash and Cash Equivalents

The USO considers all highly liquid investments purchased with an initial maturity of three months or less to be cash equivalents.

Investments

Investments in publicly traded debt and equity securities are recorded at fair value generally determined on the basis of quoted market values. Investment income is presented net of investment advisory/management fees in the accompanying consolidated statement of activities.

Programmatic Investments

Investments that are made to further the mission of the USO and for which the production of income or the appreciation of assets is not a significant purpose are classified as programmatic investments. As of December 31, 2013 and 2012, programmatic investments are comprised of capitalized costs related to the construction of family centers that the USO intends to gift to the United States Government at completion.

Inventory

Inventories are stated at the lower of cost or market determined on a first-in, first-out basis and average cost methods.

Contributed product inventory is recorded at the fair value on the date received. Management periodically reviews inventory levels for slow-moving or obsolete inventory and adjusts the fair value, if necessary.

United Service Organizations, Inc.

Notes to Consolidated Financial Statements—Continued

December 31, 2013 and 2012

NOTE B—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

Fixed Assets

Furniture, fixtures, equipment, and other capitalized assets are recorded at cost and are depreciated using the straight-line method over the estimated useful lives of the respective assets, which range from three to seven years. Leasehold improvements are amortized using the straight-line method over the lesser of the terms of the lease or the expected useful lives of the improvements.

Contributed Materials and Facilities

Donated facilities, equipment use, materials and supplies received from the United States Government and other donors are reflected in the accompanying consolidated financial statements as support to the USO at the estimated fair value when received or when an unconditional pledge to contribute has been made.

Contributed Services

The USO recognizes contributions of services received if such services (a) create or enhance non-financial assets or (b) require specialized skills, are provided by individuals possessing those skills and would typically need to be purchased if not contributed.

The USO receives contributions of services from celebrities in order to carry out its program of providing free celebrity entertainment tours for military personnel around the world. The USO also receives contributions of media air time to promote its Public Service Announcements. These contributions of services are reflected in the accompanying consolidated financial statements as support to the USO at the estimated fair value when received. As these contributions of services are expended in the year that the services are provided, a corresponding expense equal to the estimated fair market value of the services provided is recognized in the accompanying consolidated financial statements.

In addition, USO receives services from a large number of volunteers who give significant amounts of time to the USO's programs. No amounts have been reflected for these types of donated services, as they do not meet the criteria outlined above.

Contributions

Contributions, including unconditional promises to give, are recognized as revenues in the period received or pledged. Conditional promises to give are not recognized until the conditions on which they depend are substantially met. All contributions are considered to be available for unrestricted use, unless specifically restricted by the donor. Contributions with temporary, donor-imposed time or purpose restrictions are recorded as temporarily restricted support. A donor restriction expires when a stipulated time restriction ends or when a purpose restriction is accomplished. Upon expiration, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statement of activities as net assets released from restrictions. Restricted contributions received in the same year in which the restrictions are met are recorded as an increase to temporarily restricted support at the time of receipt and as net assets released from restrictions. The principal and any donor restricted income from permanently restricted contributions are classified as permanently restricted net assets. Income on those assets, not permanently restricted by the donor, is classified as temporarily restricted.

United Service Organizations, Inc.

Notes to Consolidated Financial Statements—Continued

December 31, 2013 and 2012

NOTE B—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

Contributions—Continued

Unconditional promises to give that are expected to be collected within one year are recorded at their 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 credit-adjusted interest rates determined at the time the promise to give is made by a donor. Amortization of the discounts is included in contribution revenue in the accompanying consolidated statement of activities. Allowances are recorded for estimated uncollectible contributions based upon management's judgment and analysis of the creditworthiness of the donors, past collection experience, and other relevant factors.

Unconditional promises to give product inventory that are expected to be received within three months or less are recorded at their net realizable value which is the estimated fair value based on a minimal timeframe between promise to give and receipt of goods. Inventory receivables are recorded at wholesale value. Wholesale value of the items donated is determined based on management's best estimate using information provided by donors and other third parties. The USO does not accept or record inventory receivables that are expected to be collected in greater than one year. Management considers all promises to give of product inventory to be fully collectible, therefore no allowance is recorded. As of December 31, 2013 and 2012, contributions receivable included \$229,725 and \$0, respectively, of unconditional promises to give product inventory.

Grant Revenue

Grant revenue on cost-reimbursement grants or contracts is recognized when program expenditures have been incurred. Billed and unbilled receivables of the government grants are expected to be collected within one year and are recorded at net realizable value as grant receivables in the consolidated statement of financial position. Such grant programs are subject to independent audit under the Office of Management and Budget Circular A-133 and review by grantor agencies. Such review could result in the disallowance of expenditures under the terms of the grant or reductions of future grant funds. Based on prior experience, the USO's management believes that costs ultimately disallowed, if any, would not materially affect the consolidated financial position of the USO.

USO Center Revenue

USO Center Revenue represents amounts collected for cultural tours, canteen operations, gift shops and a variety of other activities of USO Centers located at military installations around the world. Revenue is recorded when earned. Amounts received in advance for tours and other activities are recorded as deferred revenue and included in accounts payable and accrued expenses in the accompanying consolidated statements of financial position.

United Service Organizations, Inc.

Notes to Consolidated Financial Statements—Continued

December 31, 2013 and 2012

NOTE B—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

Other Receivables

The carrying value of the USO's other receivables represents their estimated net realizable value. As of December 31, 2013 and 2012, the USO has recorded an allowance for doubtful accounts against other receivables of \$150,000.

Concentration of Credit Risk

Financial instruments that potentially subject the USO to a concentration of credit risk include cash deposits with commercial banks. The USO's cash management policies limit its exposure to a concentration of credit risk by maintaining cash accounts at financial institutions whose deposits are insured by the Federal Deposit Insurance Corporation (FDIC). Cash deposits may exceed the FDIC insurable limits at times throughout the year due to anticipated large expenses under various projects. As of December 31, 2013, balances held in accounts in excess of the FDIC insurable limit were approximately \$21,466,000. Management does not consider this to be a significant credit risk. Amounts in foreign bank accounts total approximately \$954,000 at December 31, 2013.

Functional Allocation of Expenses

The costs of providing various programs and supporting services have been summarized on a functional basis in the accompanying consolidated schedules of functional expenses. Certain costs have been allocated among the program and supporting services benefited.

Income Taxes

The USO is exempt from federal income tax under Section 501(a) of the Internal Revenue Code (IRC) of 1986, as amended, as an organization described in IRC Section 501(c)(3). However, income generated from activities unrelated to the USO's exempt purpose is subject to tax under IRC Section 511. The USO did not have any material unrelated business income tax liability for the years ended December 31, 2013 and 2012. Therefore, no tax liability has been provided in the accompanying consolidated financial statements.

US GAAP requires that a tax position be recognized or derecognized based on a "more likely than not" threshold. This applies to positions taken or expected to be taken in a tax return. The USO does not believe its consolidated financial statements include any uncertain tax positions for the open tax years.

Prior Year Summarized Information

The consolidated financial statements include certain prior year summarized comparative information in total but not by asset class. Such information does not include sufficient detail to constitute a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the USO's consolidated financial statements for the year ended December 31, 2012, from which the summarized information was derived.

United Service Organizations, Inc.

Notes to Consolidated Financial Statements—Continued

December 31, 2013 and 2012

NOTE B—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

USO Foundation

The USO Foundation (Foundation) was incorporated as a supporting organization on March 22, 2007 to carry out and support the general charitable purposes of the USO. The Foundation's accounts are included in the consolidated financial statements.

Reclassifications

Certain reclassifications have been made to the December 31, 2012 amounts to conform to the December 31, 2013 presentation. Such reclassifications did not change total assets, liabilities, revenues and expenses or changes in net assets reflected in the 2012 consolidated financial statements.

NOTE C—CONTRIBUTIONS RECEIVABLE, NET

Contributions receivable, net consist of the following unconditional promises to give as of December 31, 2013:

	Unrestricted	Temporarily Restricted	Total
Less than one year	\$ 14,173,181	\$ 1,632,228	\$ 15,805,409
One to five years	—	2,517,000	2,517,000
	14,173,181	4,149,228	18,322,409
Discount	—	(35,096)	(35,096)
	\$ 14,173,181	\$ 4,114,132	\$ 18,287,313

United Service Organizations, Inc.

Notes to Consolidated Financial Statements—Continued

December 31, 2013 and 2012

NOTE C—CONTRIBUTIONS RECEIVABLE, NET—Continued

Contributions receivable, net consist of the following unconditional promises to give as of December 31, 2012:

	Unrestricted	Temporarily Restricted	Total
Less than one year	\$ 7,895,690	\$ 3,694,127	\$ 11,589,817
One to five years	10,000	2,379,000	2,389,000
	7,905,690	6,073,127	13,978,817
Discount	(364)	(62,176)	(62,540)
	\$ 7,905,326	\$ 6,010,951	\$ 13,916,277

An allowance for uncollectable accounts totaling \$122,250 and \$184,000 existed at December 31, 2013 and 2012, respectively.

NOTE D—INVESTMENTS

At December 31, investments are recorded at fair value and consist of the following:

	2013	2012
Corporate and commercial obligations	\$ 7,085,110	\$ 6,460,227
U.S. Treasury securities and other government obligations	552,032	595,865
Corporate equity securities	5,054,209	4,639,641
Mutual funds	62,436,918	56,792,161
Money market holdings	3,047,694	3,204,508
	\$ 78,175,963	\$ 71,692,402

United Service Organizations, Inc.

Notes to Consolidated Financial Statements—Continued

December 31, 2013 and 2012

NOTE D—INVESTMENTS—Continued

The USO has adopted guidance that defines fair value, establishes a framework for measuring fair value, establishes a fair value hierarchy based on the inputs used to measure fair value and enhances disclosure requirements for fair value measurements. The guidance maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the observable inputs be used when available.

Observable inputs are inputs that market participants would use in pricing the asset or liability based on market data obtained from independent sources. Unobservable inputs reflect assumptions that market participants would use in pricing the asset or liability based on the best information available in the circumstances. The hierarchy is broken down into three levels based on the transparency of inputs as follows:

Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the report date. A quoted price for an identical asset or liability in an active market provides the most reliable fair value measurement because it is directly observable to the market.

Level 2 – Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of the report date. The nature of these securities include investments for which quoted prices are available but traded less frequently and investments that are fair valued using other securities, the parameters of which can be directly observed.

Level 3 – Securities that have little to no pricing observability as of the report date. These securities are measured using management's best estimate of fair value, where the inputs into the determination of fair value are not observable and require significant management judgment or estimation.

Inputs are used in applying the various valuation techniques and broadly refer to the assumptions that market participants use to make valuation decisions, including assumptions about risk. Inputs may include price information, volatility statistics, specific and broad credit data, liquidity statistics, and other factors. A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. However, the determination of what constitutes "observable" requires significant judgment by the USO.

The USO considers observable data to be market data that is readily available, regularly distributed or updated, reliable and verifiable, not proprietary, and provided by independent sources that are actively involved in the relevant market. The categorization of a financial instrument within the hierarchy is based upon the pricing transparency of the instrument and does not necessarily correspond to the USO's perceived risk of that instrument.

United Service Organizations, Inc.

Notes to Consolidated Financial Statements—Continued

December 31, 2013 and 2012

NOTE D—INVESTMENTS—Continued

Investments were recorded at fair value as of December 31, 2013 based on the following level of hierarchy:

	Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Corporate and commercial obligations	\$ 7,085,110	\$ 4,241,300	\$ 2,843,810	\$ —
U.S. Treasury securities and other government obligations	552,032	552,032	—	—
Mutual funds	62,436,918	62,436,918	—	—
Corporate equity securities	5,054,209	5,054,209	—	—
Money market holdings	3,047,694	3,047,694	—	—
	<u>\$ 78,175,963</u>	<u>\$ 75,332,153</u>	<u>\$ 2,843,810</u>	<u>\$ —</u>

Investments were recorded at fair value as of December 31, 2012 based on the following level of hierarchy:

	Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Corporate and commercial obligations	\$ 6,460,227	\$ 3,918,027	\$ 2,542,200	\$ —
U.S. Treasury securities and other government obligations	595,865	347,265	248,600	—
Mutual funds	56,792,161	56,792,161	—	—
Corporate equity securities	4,639,641	4,639,641	—	—
Money market holdings	3,204,508	3,204,508	—	—
	<u>\$ 71,692,402</u>	<u>\$ 68,901,602</u>	<u>\$ 2,790,800</u>	<u>\$ —</u>

United Service Organizations, Inc.

Notes to Consolidated Financial Statements—Continued

December 31, 2013 and 2012

NOTE D—INVESTMENTS—Continued

The following schedule summarizes investment return:

	2013	2012
Interest and dividends	\$ 2,108,284	\$ 1,821,515
Net unrealized gains	3,036,209	3,401,499
Net realized gains	2,020,638	1,391,982
Less: investment expenses	(266,096)	(247,239)
	\$ 6,899,035	\$ 6,367,757

NOTE E—PROGRAMMATIC INVESTMENTS

On December 18, 2009, the USO made a commitment to the United States Department of the Army (“Army”) to donate a USO Family Center (“Fort Belvoir Center”) at Fort Belvoir, Virginia. In addition, on December 17, 2009, the USO made a similar commitment to the United States Department of the Navy to donate a USO Family Center (“Bethesda Center”) at Naval Support Activity, Bethesda. The purpose of the donations are to provide centers for use by wounded, ill and injured service members, their families, and primary caregivers at both locations. The costs incurred by the USO to construct these centers have been classified as programmatic investments.

As of December 31, 2012, all conditions of the commitment relating to the Fort Belvoir Center were met; and therefore the USO has reduced its programmatic investment and recognized programmatic expense in the accompanying 2012 financial statements of approximately \$9.5 million, comprised of the independently appraised value of the completed and contributed building of \$7.5 million plus additional directly related programmatic investment construction, design and other costs. The independent appraisal of the completed building was predicated upon the use of data for a recently constructed church facility as a deemed comparable use facility, and was further limited by the special purpose nature of the building and restrictions based on its location on a military installation. All of the \$9.5 million in costs incurred relating to the program project were paid for by the USO at fair market value.

As of December 31, 2013, the USO has recorded a programmatic investment related to the Bethesda Center equal to an independently appraised value of the building of \$6 million, comprised of approximately \$10 million of project costs and a valuation allowance of \$4 million. The \$4 million valuation allowance has been recognized as programmatic expense in the consolidated statement of activities and changes in net assets. The independent appraisal of the completed building was predicated upon the use of data for recent sales of daycare facilities as deemed comparable use facilities, and was further limited by the special purpose nature of the building and restrictions based on its location on a military installation. All costs incurred relating to the program project were paid for by the USO at fair market value.

United Service Organizations, Inc.

Notes to Consolidated Financial Statements—Continued

December 31, 2013 and 2012

NOTE E—PROGRAMMATIC INVESTMENTS—Continued

At December 31, 2012, costs of \$1.8 million related to the construction of the Bethesda Center were capitalized as programmatic investments and approximated fair value.

The following is a summary of programmatic investments as of December 31:

	2013	2012
Bethesda Center	\$ 5,950,000	\$ 1,815,137
	\$ 5,950,000	\$ 1,815,137

NOTE F—COMMITMENTS AND CONTINGENCIES

Operating Leases

The USO leases office space and equipment under long-term lease agreements. The office leases provide for scheduled rent increases and increases in operating expenses and real estate taxes attributable to the leased property and expire in January 2017. As part of a lease agreement, the USO received eight months of free rent on a portion of the space and reimbursement for certain leasehold improvements as lease incentives, which are recorded as deferred rent in the accompanying consolidated statements of financial position. Scheduled rent increases and these incentives are being recognized over the term of the lease on a straight-line basis. Future minimum payments under this operating lease and other equipment operating leases are as follows:

2014	\$ 1,171,700
2015	1,200,992
2016	1,231,017
2017	103,426
	<u>\$ 3,707,135</u>

For the years ended December 31, 2013 and 2012, total rental expense under all operating leases was \$1,103,040 and \$1,085,554, respectively (excluding related in-kind support).

Other

The USO is subject to claims and suits arising in the ordinary course of its operations. In the opinion of management, the ultimate resolution of any outstanding legal proceedings will not have a material effect on the USO's financial position, change in net assets, or cash flows.

United Service Organizations, Inc.

Notes to Consolidated Financial Statements—Continued

December 31, 2013 and 2012

NOTE F—COMMITMENTS AND CONTINGENCIES—Continued

Construction Contract

On February 12, 2013, the USO entered into a contract for approximately \$9 million with a construction company to serve as general contractor to the USO in connection with the construction of a two story multi-use facility, serving United States Department of Defense (“DoD”) service members, their families and primary care givers, to include: healing gardens, outdoor fitness and recreation areas, as well as other associated site, mechanical and electrical work. The remaining commitment under the contract totaled approximately \$2,810,000 as of December 31, 2013. Of this amount, approximately \$1,183,000 is included in accounts payable and accrued expenses as of December 31, 2013.

NOTE G—FIXED ASSETS

At December 31, fixed assets consist of the following:

	2013	2012
Furniture, fixtures, and equipment	\$ 11,216,113	\$ 9,862,046
Leasehold improvements	9,684,727	9,458,545
	20,900,840	19,320,591
Less: accumulated depreciation and amortization	(14,058,823)	(11,560,925)
	\$ 6,842,017	\$ 7,759,666

United Service Organizations, Inc.

Notes to Consolidated Financial Statements—Continued

December 31, 2013 and 2012

NOTE H—NET ASSETS RELEASED FROM RESTRICTIONS

Net assets were released from temporary donor restrictions by incurring expenses satisfying the restricted purposes specified by the donors or by the passage of time during the years ended December 31, 2013 and 2012, as follows:

	2013	2012
Desert Storm Education Fund	\$ 19,608	\$ 18,852
Ongoing Program Activities	4,768,797	4,640,412
USO Warrior and Family Care	13,658,585	12,980,721
USO Centers and Councils	978,507	1,835,874
	<u>\$ 19,425,497</u>	<u>\$ 19,475,859</u>

NOTE I—ALLOCATION OF JOINT COSTS

The USO conducts direct response mail campaigns that include fund-raising appeals, as well as program and management and general components. The costs of conducting those joint activities were allocated as follows in 2013 and 2012:

	2013	2012
Programs	\$ 10,124,021	\$ 9,030,575
Management and general	6,814,373	6,207,746
Fundraising	14,034,857	12,434,954
	<u>\$ 30,973,251</u>	<u>\$ 27,673,275</u>

United Service Organizations, Inc.

Notes to Consolidated Financial Statements—Continued

December 31, 2013 and 2012

NOTE J—CONTRIBUTED MATERIALS, FACILITIES AND SERVICES

A summary by category of in-kind support donated for the years ended December 31, is as follows:

	2013	2012
Materials, facilities, and other services	\$ 17,493,591	\$ 14,924,920
Public Service Announcements	9,524,770	67,500,518
Celebrity entertainment	48,787,833	54,512,900
	<hr/> \$ 75,806,194	<hr/> \$ 136,938,338

NOTE K—RETIREMENT PLAN

The USO maintains a 401(a) with a 401(k) component plan named the United Service Organizations Retirement Savings Plan (RSP). The RSP allows eligible participants to contribute both pre-tax and Roth contributions to the RSP, as well as, allows the USO to contribute both employer matching contributions and safe harbor non-elective contributions. Employer matching contributions vest 100 percent over a period of five years; whereas, safe harbor non-elective contributions vest 100 percent over a period of 2 years. In 2013 and 2012, the USO contributed a safe harbor non-elective contribution on behalf of each eligible employee in an amount equal to 4 percent of the employee's compensation without regard to whether the employee makes any employee contributions, subject to federal limitations. Additionally, in 2013 and 2012, the USO contributed a discretionary employer matching contribution equal to 100% of the employee's salary deferral contributions, up to a maximum of 5% of the employee's compensation.

The USO's policy is to fund retirement plan costs as accrued. Retirement plan expense was \$1,928,427 and \$1,270,675 for the years ended December 31, 2013 and 2012, respectively.

United Service Organizations, Inc.

Notes to Consolidated Financial Statements—Continued

December 31, 2013 and 2012

NOTE L—ENDOWMENT

The Spirit of Hope endowment includes both donor-restricted endowment funds and funds designated by the Board of Governors to function as endowments. As required by GAAP, net assets associated with endowment funds, including funds designated by the Board of Governors to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

During 2008, the District of Columbia enacted into law the Uniform Prudent Management of Institutional Funds Act (UPMIFA). Management of the USO has interpreted the District of Columbia law as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the USO classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the organization in a manner consistent with the standard of prudence prescribed by UPMIFA. As of December 31, 2013, there are no plans for the earnings of the endowment to be spent.

The USO has adopted an investment policy for the endowment fund. This investment policy is based on growing the endowment fund to provide financial stability for the USO in perpetuity with no short term plans for withdraws from the fund. The USO's ability to tolerate risk and volatility should be consistent with that of a conservative growth portfolio, with investments made in companies that demonstrate consistent growth over time. Asset allocations are developed in accordance with this long-term, conservative growth strategy.

United Service Organizations, Inc.

Notes to Consolidated Financial Statements—Continued

December 31, 2013 and 2012

NOTE L—ENDOWMENT—Continued

The following illustrates endowment net asset composition by type of fund and the changes in endowment net assets for the year ended December 31:

2013	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ —	\$ 16,571,470	\$ 25,597,923	\$ 42,169,393
Board-designated endowment funds	35,656,381	—	—	35,656,381
Total funds	\$ 35,656,381	\$ 16,571,470	\$ 25,597,923	\$ 77,825,774
2013	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	\$ 32,517,371	\$ 12,863,002	\$ 25,597,923	\$ 70,978,296
Investment return:				
Investment income	834,037	985,829	—	1,819,866
Net appreciation	2,304,973	2,722,639	—	5,027,612
Total investment return	3,139,010	3,708,468	—	6,847,478
Endowment net assets, end of year	\$ 35,656,381	\$ 16,571,470	\$ 25,597,923	\$ 77,825,774

United Service Organizations, Inc.

Notes to Consolidated Financial Statements—Continued

December 31, 2013 and 2012

NOTE L—ENDOWMENT—Continued

The following illustrates endowment net asset composition by type of fund and the changes in endowment net assets for the year ended December 31:

2012	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ —	\$ 12,863,002	\$ 25,597,923	\$ 38,460,925
Board-designated endowment funds	32,517,371	—	—	32,517,371
Total funds	\$ 32,517,371	\$ 12,863,002	\$ 25,597,923	\$ 70,978,296
2012	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	\$ 29,628,693	\$ 9,448,551	\$ 25,597,923	\$ 64,675,167
Investment return:				
Investment income	712,582	842,280	—	1,554,862
Net appreciation	2,176,096	2,572,171	—	4,748,267
Total investment return	2,888,678	3,414,451	—	6,303,129
Endowment net assets, end of year	\$ 32,517,371	\$ 12,863,002	\$ 25,597,923	\$ 70,978,296

United Service Organizations, Inc.

Notes to Consolidated Financial Statements—Continued

December 31, 2013 and 2012

NOTE M—SUBSEQUENT EVENTS

The USO evaluated its December 31, 2013 consolidated financial statements for subsequent events through, March 26, 2014, the date the consolidated financial statements were available to be issued.

The USO is not aware of any subsequent events which would require disclosure in the consolidated financial statements.

Supplemental Information



United Service Organizations, Inc.

Consolidated Schedule of Functional Expenses

December 31,

2013

	Program Services				Fund-raising	Management and General	Total Operating Expenses
	USO Centers	Programs	Entertainment	Communications and Public Awareness Outreach			
Salaries	\$ 16,411,503	\$ 1,232,550	\$ 953,808	2,981,484	\$ 3,052,949	\$ 5,167,568	\$ 29,799,862
Payroll taxes	1,336,901	83,729	64,374	215,877	222,498	335,076	2,258,455
Retirement plan	998,032	80,504	66,111	224,793	1,369,440	349,420	1,928,427
Employee benefits	1,308,287	102,742	55,522	268,128	224,313	488,697	2,447,689
Total salaries and related expenses	20,054,723	1,499,525	1,139,815	3,690,282	3,709,327	6,340,761	36,434,433
Contribution of center and related costs	6,148,059	—	—	—	—	—	6,148,059
Program supplies and services	20,535,960	9,539,199	49,123,887	—	79,199,046	—	79,199,046
Office expenses	700,777	14,370	4,103	25,519	744,769	124,520	1,010,642
Information Technology	1,156,237	3,387,834	61,985	309,926	4,915,982	379,687	5,573,389
Printing and production	44,028	1,597	3,075,920	4,655,850	7,777,395	3,190,012	21,923,903
Marketing and promotion	99,576	109	—	10,482,359	10,582,044	3,550	11,536,696
Awards and grants	2,032,205	19,608	—	—	2,051,813	—	2,051,813
Professional fees	415,489	239,411	876,110	3,156,203	4,687,213	2,305,842	10,199,003
Subscriptions, dues, and staff training	59,317	4,169	5,813	31,589	100,888	194,505	426,515
Travel	1,378,008	801,121	3,456,651	369,388	6,005,168	328,833	6,979,654
General insurance	135,425	33,587	10,019	39,455	218,486	58,067	320,171
Occupancy	388,903	167,036	59,064	229,121	844,124	350,628	1,448,259
Rental and maintenance of equipment	442,640	35,059	7,547	30,189	515,435	44,339	589,019
Postage and shipping	138,637	721,456	10,155	4,747,302	5,617,550	2,767,421	11,157,622
Meetings, conferences and events	217,628	5,419	15,194	94,514	332,755	92,246	997,405
Depreciation and amortization	2,314,487	42,398	40,741	40,741	2,438,367	40,739	2,519,847
Other expenses	82,258	48,063	54,069	—	184,390	81,194	599,276
Total	\$ 56,344,357	\$ 16,559,961	\$ 57,941,073	\$ 27,902,438	\$ 158,747,829	\$ 24,064,579	\$ 199,114,752
Note: In-kind expenses included in supplies and services, marketing and promotion, professional fees, postage and shipping, subscriptions, dues, and staff training, and meetings, conferences and events	\$ 14,340,049	\$ 3,253,603	\$ 48,818,454	\$ 9,594,804	\$ 76,006,910	\$ 119,491	\$ 76,220,052

The accompanying notes are an integral part of this statement.

United Service Organizations, Inc.

Consolidated Schedule of Functional Expenses

December 31,

2012

	Program Services					Fund-raising	Management and General	Total Operating Expenses
	USO Centers	Programs	Entertainment	Communications and Public Awareness Outreach	Total			
Salaries	\$ 15,201,747	\$ 1,215,841	\$ 897,083	2,840,066	\$ 20,154,737	\$ 2,825,447	\$ 4,522,326	\$ 27,502,510
Payroll taxes	1,266,538	72,011	66,588	201,634	1,606,771	204,250	288,273	2,099,294
Retirement plan	639,254	54,638	45,473	147,541	886,906	140,396	243,373	1,270,675
Employee benefits	1,309,643	87,469	57,463	227,576	1,682,151	198,771	373,006	2,253,928
Total salaries and related expenses	18,417,182	1,429,959	1,066,607	3,416,817	24,330,565	3,368,864	5,426,978	33,126,407
Contribution of center and related costs	10,075,232	—	—	—	10,075,232	—	—	10,075,232
Program supplies and services	18,079,643	10,119,091	56,000,784	—	84,199,518	—	—	84,199,518
Office expenses	650,993	18,985	5,307	9,414	684,699	132,177	135,009	951,885
Information Technology	927,585	3,995,300	57,196	244,537	5,224,618	236,855	331,473	5,792,946
Printing and production	37,350	2,309	1,876,560	4,531,772	6,447,991	10,016,807	2,963,360	19,428,158
Marketing and promotion	89,017	60	5,125	68,669,197	68,763,399	783,081	12,797	69,559,277
Awards and grants	1,671,319	18,852	—	—	1,690,171	—	—	1,690,171
Professional fees	370,273	345,114	902,055	2,819,874	4,437,316	2,327,971	1,993,760	8,759,047
Subscriptions, dues, and staff training	109,032	21,771	11,537	43,270	185,610	151,891	124,677	462,178
Travel	1,545,458	120,992	3,237,240	310,356	5,214,046	599,720	211,039	6,024,805
General insurance	126,895	28,783	11,506	38,917	206,101	38,341	67,246	311,688
Occupancy	355,817	149,185	68,203	233,775	806,980	222,091	362,725	1,391,796
Rental and maintenance of equipment	371,650	36,509	5,232	18,965	432,356	24,197	28,774	485,327
Postage and shipping	127,710	869,679	13,178	3,513,300	4,523,867	2,027,507	2,126,255	8,677,629
Meetings, conferences and events	2,536	1,693	8,497	83,095	95,821	641,618	58,215	795,654
Depreciation and amortization	2,254,858	56,029	52,716	52,716	2,416,319	52,716	52,717	2,521,752
Other expenses	206,876	49,969	50,966	—	307,811	287,857	227,327	822,995
Total	\$ 55,419,426	\$ 17,264,280	\$ 63,372,709	\$ 83,986,005	\$ 220,042,420	\$ 20,911,693	\$ 14,122,352	\$ 255,076,465
Note: In-kind expenses included in supplies and services, marketing and promotion, professional fees, postage and shipping, subscriptions, dues, and staff training, and meetings, conferences and events	\$ 11,895,125	\$ 3,856,602	\$ 54,541,572	\$ 67,585,765	\$ 137,879,064	\$ 113,233	\$ 61,455	\$ 138,053,752

The accompanying notes are an integral part of this statement.