

Consolidated Financial Statements and Report of
Independent Certified Public Accountants

United Service Organizations, Inc.

December 31, 2010

United Service Organizations, Inc.

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Report of Independent Certified Public Accountants

Board of Governors
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We have audited the accompanying consolidated statement of financial position of United Service Organizations, Inc. (USO) as of December 31, 2010, and the related consolidated statements of activities and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of USO's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year summarized comparative information has been derived from USO's 2009 financial statements and, in our report dated March 5, 2010, we expressed an unqualified opinion on those financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America as established by the American Institute of Certified Public Accountants. 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 USO'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 audit provides a reasonable basis for our 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, 2010, and the change in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 11, 2011 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 USO's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Our audit was conducted for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The supplemental consolidated schedule of functional expenses is presented for the purpose of additional analysis and is not a required part of the basic consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic consolidated financial statements taken as a whole.

Grant Thornton LLP

McLean, Virginia
April 11, 2011

United Service Organizations, Inc.

Consolidated Statement of Financial Position

December 31, 2010 (with comparative totals as of December 31, 2009)

Assets

Cash and cash equivalents	\$ 11,517,944	\$ 12,223,259
Contributions receivable, net	8,378,463	5,022,507
Grants receivable	4,080,769	5,493,207
Other receivables	411,324	472,293
Prepaid expenses and other assets	799,498	1,421,188
Inventory	2,013,246	2,517,113
Investments	65,774,602	57,524,642
Fixed assets--net	10,452,350	7,243,070

Total Assets	\$ 103,428,196	\$ 91,917,279
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Liabilities and Net Assets

Liabilities

Accounts payable and accrued expenses	\$ 12,001,624	\$ 8,528,460
Deferred rent	497,605	588,843

Total Liabilities	12,499,229	9,117,303
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Net Assets

Unrestricted		
Operating	16,230,194	21,313,717
Board-designated		
Spirit of Hope	29,714,630	26,064,567

Total unrestricted	45,944,824	47,378,284
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Temporarily restricted		
Desert Storm Education Fund	627,570	635,880
Spirit of Hope	9,550,130	5,235,710
Time Restriction	44,031	85,000
Ongoing Program Activities	4,661,319	3,186,188
Capital Projects	4,237,665	572,818
USO Councils and Others	265,505	108,173

Total temporarily restricted	19,386,220	9,823,769
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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
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Total Net Assets	90,928,967	82,799,976
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Total Liabilities and Net Assets	\$ 103,428,196	\$ 91,917,279
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The accompanying notes are an integral part of this statement.

United Service Organizations, Inc.

Consolidated Statement of Activities and Changes in Net Assets

Year ended December 31, 2010 (with comparative totals for the year ended December 31, 2009)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Total
Revenue and Support					
Programs					
USO center revenue	\$ 7,339,783	\$ —	\$ —	\$ 7,339,783	\$ 8,026,615
Contributed materials, facilities and services	206,170,704	2,795,764	—	208,966,468	148,456,614
Grants and sponsorships	23,788,840	711,485	—	24,500,325	16,190,953
Public support					
Corporate, foundation and individual giving	10,333,426	9,459,465	—	19,792,891	13,095,464
Direct response	60,664,759	2,569,039	—	63,233,798	55,440,997
United way, CFC and other federated	2,270,221	—	—	2,270,221	1,988,080
Investment income	3,654,911	4,381,658	—	8,036,569	9,904,263
Other income	248,287	—	—	248,287	203,137
Total Revenue and Support	314,470,931	19,917,411	—	334,388,342	253,311,123
Net Assets Released from Restrictions	10,354,960	(10,354,960)	—	—	—
Total Revenue and Other Support	324,825,891	9,562,451	—	334,388,342	253,311,123
Operating Expenses					
Program services					
USO operations	51,773,903	—	—	51,773,903	46,480,212
Contributed materials, facilities and services	209,731,791	—	—	209,731,791	146,443,359
Entertainment	11,302,892	—	—	11,302,892	7,221,197
Communications and public awareness outreach	17,744,025	—	—	17,744,025	15,156,647
Total program expenses	290,552,611	—	—	290,552,611	215,301,415
Supporting Services					
Fundraising	22,831,954	—	—	22,831,954	16,780,672
Management and general	12,874,786	—	—	12,874,786	11,512,646
Total Supporting Services	35,706,740	—	—	35,706,740	28,293,318
Total Operating Expenses	326,259,351	—	—	326,259,351	243,594,733
Changes in Net Assets	(1,433,460)	9,562,451	—	8,128,991	9,716,390
Net Assets, beginning of year	47,378,284	9,823,769	25,597,923	82,799,976	73,083,586
Net Assets, end of year	\$ 45,944,824	\$ 19,386,220	\$ 25,597,923	\$ 90,928,967	\$ 82,799,976

The accompanying notes are an integral part of this statement.

United Service Organizations, Inc.

Consolidated Statement of Cash Flows

Year ended December 31, 2010 (with comparative totals for the year ended December 31, 2009)

Cash Flows from Operating Activities		
Change in net assets	\$ 8,128,991	\$ 9,716,390
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Depreciation and amortization	2,329,017	1,510,117
Contributed investments	(707,696)	(1,110,646)
Realized/unrealized gain on investments	(6,545,534)	(8,633,278)
Revenue from contributed inventory	(2,680,324)	(6,084,277)
Contributed inventory used	3,445,647	4,071,022
(Gain) loss on disposal of fixed assets	(108,176)	992
Changes in assets and liabilities		
Contributions receivable, net	(3,355,956)	(1,503,863)
Grants and other receivables	1,473,407	700,932
Prepaid expenses and other assets	621,690	(610,281)
Inventory	(261,456)	(53,542)
Accounts payable and accrued expenses	3,473,164	(26,702)
Deferred rent	(91,238)	(71,171)
Net Cash Provided by (Used in) Operating Activities	5,721,536	(2,094,307)
Cash Flows from Investing Activities		
Purchase of fixed assets	(5,543,612)	(4,110,218)
Proceeds from the sale of fixed assets	113,491	1,000
Purchase of investments	(48,075,801)	(40,643,345)
Sales of investments	47,079,071	41,095,785
Net Cash Used in Investing Activities	(6,426,851)	(3,656,778)
Net Decrease in Cash and Cash Equivalents	(705,315)	(5,751,085)
Cash and Cash Equivalents, beginning of year	12,223,259	17,974,344
Cash and Cash Equivalents, end of year	\$ 11,517,944	\$ 12,223,259

The accompanying notes are an integral part of this statement.

United Service Organizations, Inc.

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

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. 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. It relies on the generosity of individuals, organizations and corporations to support its activities. For 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 this mission, USO operates Centers at major military installations and airports around the world, produces free celebrity entertainment tours for military personnel, and provides programs and services to troops and their families to meet their ever-changing needs.

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 USO and are, therefore, excluded from 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, 2010 and 2009

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.
- *Time Restriction*—Certain contributions receivable result from multi-year pledges, and accordingly the amounts due in future years (at their discounted value) have been recorded as temporarily restricted until the year when the pledge becomes due.
- *Ongoing Program Activities*—Contributions restricted for various worldwide USO programs, such as Operation USO Care Package, USO Operation Phone Home, USO2GO, USO Wounded Warriors, and United Through Reading's Military Program.
- *Capital Projects*—Contributions restricted for the establishment, expansion or capital improvements of various USO Centers worldwide, including the USO Family Centers related to the Operation Enduring Care initiative.
- *USO Councils and Others*—Donor funds restricted for use in certain regional localities.
- *Spirit of Hope*—Earning on donor-restricted endowment funds classified as temporarily restricted net assets until those amounts are appropriated for expenditure.

United Service Organizations, Inc.

Notes to Consolidated Financial Statements—Continued

December 31, 2010 and 2009

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

USO operates Centers at major 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

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. All investment income is reported as a change in unrestricted net assets unless otherwise restricted by the donor.

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.

Inventory

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

United Service Organizations, Inc.

Notes to Consolidated Financial Statements—Continued

December 31, 2010 and 2009

NOTE B—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

Contributed Materials and Facilities

Donated facilities, equipment use, supplies and materials 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

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.

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. 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 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 USO's programs. No amounts have been reflected for these types of donated services, as they do not meet the criteria outlined above.

Contributions

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.

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 risk-free interest rates applicable to the years in which the promises are received. The discount rate used in 2010 was 1.8 percent. Amortization of the discounts is included in contribution revenue in the accompanying consolidated statement of activities.

United Service Organizations, Inc.

Notes to Consolidated Financial Statements—Continued

December 31, 2010 and 2009

NOTE B—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

Grants and Sponsorships

Grant revenue on cost-reimbursement grants or contracts is recognized when USO requests reimbursement from granting agencies after the 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, USO's management believes that costs ultimately disallowed, if any, would not materially affect the consolidated financial position of 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 worldwide. Revenue is recorded when earned.

Concentration of Credit Risk

Financial instruments that potentially subject USO to a concentration of credit risk include cash deposits with commercial banks. 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 limit of \$250,000 at times throughout the year due to anticipated large expenses under various projects. As of December 31, 2010, the amount in excess of the FDIC insurable limit was approximately \$11,500,000. Management does not consider this to be a significant credit risk. Amounts in foreign bank accounts total approximately \$686,000 at December 31, 2010.

Functional Allocation of Expenses

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

Income Taxes

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 USO's exempt purpose is subject to tax under IRC Section 511. USO did not have any material unrelated business income tax liability for the years ended December 31, 2010 and 2009. Therefore, no tax liability has been provided in the accompanying consolidated financial statements.

United Service Organizations, Inc.

Notes to Consolidated Financial Statements—Continued

December 31, 2010 and 2009

NOTE B—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

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. 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 USO's consolidated financial statements for the year ended December 31, 2009, from which the summarized information was derived.

Subsequent Events

USO evaluated its December 31, 2010 consolidated financial statements for subsequent events through April 11, 2011, the date the consolidated financial statements were available to be issued, noting no events which affect the consolidated financial statements as of December 31, 2010.

USO Foundation

USO Foundation (Foundation) was incorporated as a supporting organization on March 22, 2007 to carry out and support the general charitable purposes of USO. On January 20, 2010 and February 2, 2010, the funds constituting the corpus of the “Spirit of Hope Endowment,” which amounted to \$47.2 million in aggregate, were transferred by USO Arlington to the Foundation. The Foundation's accounts are included in the consolidated financial statements.

Reclassifications

Certain reclassifications have been made to the December 31, 2009 amounts to conform to the December 31, 2010 presentation.

United Service Organizations, Inc.

Notes to Consolidated Financial Statements—Continued

December 31, 2010 and 2009

NOTE C—CONTRIBUTIONS RECEIVABLE, NET

Contributions receivable, net consist of the following unconditional promises to give as of December 31, 2010:

	Unrestricted	Temporarily Restricted	Total
Less than one year	\$ 4,660,537	\$ 2,357,950	\$ 7,018,487
One to five years	45,000	1,370,000	1,415,000
	4,705,537	3,727,950	8,433,487
Discount	(969)	(54,055)	(55,024)
	\$ 4,704,568	\$ 3,673,895	\$ 8,378,463

An allowance for uncollectable accounts totaling \$2,165 existed at December 31, 2010.

Unconditional, unrestricted promises to give at December 31, 2009 amounted to \$3,939,005 which was due in less than one year. Temporarily restricted promises to give at December 31, 2009 amounted to \$1,083,502 which was due in less than one year. There was no allowance for uncollectable accounts at December 31, 2009.

United Service Organizations, Inc.

Notes to Consolidated Financial Statements—Continued

December 31, 2010 and 2009

NOTE D—INVESTMENTS

At December 31, investments consist of the following:

	2010	2009
Corporate and commercial obligations	\$ 7,817,584	\$ 8,787,564
U.S. Treasury securities	6,735,454	618,516
Corporate equity securities	46,841,359	36,449,847
Managed futures	—	2,328,279
Money market holdings	4,380,205	9,340,436
	<u>\$ 65,774,602</u>	<u>\$ 57,524,642</u>

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 entity.

United Service Organizations, Inc.

Notes to Consolidated Financial Statements—Continued

December 31, 2010 and 2009

NOTE D—INVESTMENTS—Continued

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 entity's perceived risk of that instrument.

Investments were recorded at fair value as of December 31, 2010 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	\$ 7,817,584	\$ 7,148,078	\$ 669,506	\$ —
U.S. Treasury securities	6,735,454	6,399,679	335,775	—
Corporate equity securities	46,841,359	46,841,359	—	—
Money market holdings	4,380,205	4,380,205	—	—
	<u>\$ 65,774,602</u>	<u>\$ 64,769,321</u>	<u>\$ 1,005,281</u>	<u>\$ —</u>

United Service Organizations, Inc.

Notes to Consolidated Financial Statements—Continued

December 31, 2010 and 2009

NOTE D—INVESTMENTS—Continued

Investments were recorded at fair value as of December 31, 2009 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	\$ 8,787,564	\$ 6,001,857	\$ 2,785,707	\$ —
U.S. Treasury securities	618,516	618,516	—	—
Corporate equity securities	36,449,847	36,449,847	—	—
Managed futures	2,328,279	—	2,328,279	—
Money market holdings	9,340,436	9,340,436	—	—
	<u>\$ 57,524,642</u>	<u>\$ 52,410,656</u>	<u>\$ 5,113,986</u>	<u>\$ —</u>

The following schedule summarizes investment return:

	2010	2009
Interest and dividends	\$ 1,719,035	\$ 1,469,437
Net unrealized gains	4,992,427	11,630,960
Net realized gains (losses)	1,553,107	(2,997,682)
Less: investment expenses	(228,000)	(198,452)
	<u>\$ 8,036,569</u>	<u>\$ 9,904,263</u>

United Service Organizations, Inc.

Notes to Consolidated Financial Statements—Continued

December 31, 2010 and 2009

NOTE E—COMMITMENTS AND CONTINGENCIES

The USO leases office space under long-term lease agreements which expire in 2014. The office leases provide for scheduled rent increases and increases in operating expenses and real estate taxes attributable to the leased property. As part of a lease agreement, 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 statement 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:

2011	\$ 948,035
2012	965,198
2013	977,787
2014	478,091
	<hr/>
	\$ 3,369,111

For the years ended December 31, 2010 and 2009, total rental expense under all operating leases was \$848,713 and \$786,624, respectively (excluding related in-kind support).

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 USO's financial position, change in net assets, or cash flows.

United Service Organizations, Inc.

Notes to Consolidated Financial Statements—Continued

December 31, 2010 and 2009

NOTE F—FIXED ASSETS

At December 31, fixed assets consist of the following:

	2010	2009
Furniture, fixtures, and equipment	\$ 8,514,910	\$ 6,333,931
Leasehold improvements	7,548,010	5,138,487
Construction in progress	1,289,307	650,884
	<u>17,352,227</u>	<u>12,123,302</u>
Less: accumulated depreciation and amortization	<u>(6,899,877)</u>	<u>(4,880,232)</u>
	<u>\$ 10,452,350</u>	<u>\$ 7,243,070</u>

NOTE G—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, 2010 and 2009, as follows:

	2010	2009
Desert Storm Education Fund	\$ 75,548	\$ 113,400
Time Restricted	85,000	248,356
Ongoing Program Activities	8,777,831	12,978,892
Capital Projects	1,416,581	—
USO Councils and others	—	35,478
	<u>\$ 10,354,960</u>	<u>\$ 13,376,126</u>

United Service Organizations, Inc.

Notes to Consolidated Financial Statements—Continued

December 31, 2010 and 2009

NOTE H—ALLOCATION OF JOINT COSTS

USO conducts direct response 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 2010 and 2009:

	2010	2009
Programs	\$ 8,425,128	\$ 8,575,956
Management and general	5,614,160	4,922,818
Fund-raising	17,268,360	12,475,878
	<u>\$ 31,307,648</u>	<u>\$ 25,974,652</u>

NOTE I—CONTRIBUTED MATERIALS, FACILITIES AND SERVICES

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

	2010	2009
Materials and facilities	\$ 15,997,490	\$ 18,887,384
Public Service Announcements	116,089,778	80,732,724
Celebrity entertainment	76,879,200	48,836,506
	<u>\$ 208,966,468</u>	<u>\$ 148,456,614</u>

NOTE J—RETIREMENT PLAN

USO maintains a defined contribution retirement plan which provides for the purchase of annuity contracts for participants upon their retirement. USO contributes 7.8 percent of each covered employee's annual salary. Employees are 100 percent vested upon five years of service once eligible.

USO's policy is to fund retirement plan costs as accrued. Retirement plan expense was \$1,437,267 and \$1,299,079 for the years ended December 31, 2010 and 2009, respectively.

United Service Organizations, Inc.

Notes to Consolidated Financial Statements—Continued

December 31, 2010 and 2009

NOTE K—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 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, 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, 2010, there are no plans for the earnings of the endowment to be spent.

USO has adopted an investment policy for the endowment fund. This investment program is based on growing the endowment fund to provide financial stability for USO in perpetuity with no short term plans for withdraws from the fund. 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, 2010 and 2009

NOTE K—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:

2010	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ —	\$ 9,550,130	\$ 25,597,923	\$ 35,148,053
Board-designated endowment funds	29,714,630	—	—	29,714,630
Total funds	\$ 29,714,630	\$ 9,550,130	\$ 25,597,923	\$ 64,862,683

2010	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	\$ 26,064,567	\$ 5,235,710	\$ 25,597,923	\$ 56,898,200
Investment return:				
Investment income	673,347	795,906	—	1,469,253
Net appreciation	2,976,716	3,518,514	—	6,495,230
Total investment return	3,650,063	4,314,420	—	7,964,483
Endowment net assets, end of year	\$ 29,714,630	\$ 9,550,130	\$ 25,597,923	\$ 64,862,683

United Service Organizations, Inc.

Notes to Consolidated Financial Statements—Continued

December 31, 2010 and 2009

NOTE K—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:

2009	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ —	\$ 5,235,710	\$ 25,597,923	\$ 30,833,633
Board-designated endowment funds	26,064,567	—	—	26,064,567
Total funds	\$ 26,064,567	\$ 5,235,710	\$ 25,597,923	\$ 56,898,200

2009	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	\$ 21,607,520	\$ —	\$ 25,597,923	\$ 47,205,443
Investment return:				
Investment income	570,365	674,178	—	1,244,543
Net appreciation	3,871,754	4,576,460	—	8,448,214
Total investment return	4,442,119	5,250,638	—	9,692,757
Adjustment from (to) Unrestricted net assets	14,928	(14,928)	—	—
Endowment net assets, end of year	\$ 26,064,567	\$ 5,235,710	\$ 25,597,923	\$ 56,898,200

Supplemental Information

United Service Organizations, Inc.

Consolidated Schedule of Functional Expenses

December 31,

2010

	Program Services					Fund-raising	Management and General	Total
	USO Operations	Entertainment	Communications and Public Awareness Outreach	Total	Operating Expenses			
Salaries	\$ 15,862,509	\$ 1,072,246	\$ 1,154,610	\$ 18,089,365	\$ 2,167,234	\$ 3,744,530	\$ 24,001,129	
Payroll taxes	1,234,442	75,078	92,692	1,402,212	163,203	249,106	1,814,521	
Employee benefits	2,207,616	146,135	185,872	2,539,623	337,413	644,273	3,521,309	
Total salaries and related expenses	19,304,567	1,293,459	1,433,174	22,031,200	2,667,850	4,637,909	29,336,959	
Supplies and services	35,622,974	77,595,860	37,599	113,256,433	514,936	217,297	113,988,666	
Printing and production	114,269	3,841,792	5,518,742	9,474,803	12,257,414	2,999,587	24,731,804	
Marketing and promotion	4,560	129,844	117,564,490	117,698,894	564,279	—	118,263,173	
Awards and grants	947,430	—	—	947,430	—	—	947,430	
Professional fees	939,253	885,911	5,162,891	6,988,055	3,036,326	2,078,392	12,102,773	
Subscriptions, dues, and staff training	159,963	29,427	20,305	209,695	83,506	30,443	323,644	
Travel	2,369,345	4,062,234	347,622	6,779,201	564,421	278,070	7,621,692	
General insurance	216,631	18,886	24,433	259,950	41,359	59,244	360,553	
Occupancy	382,079	88,908	122,241	593,228	198,335	312,044	1,103,607	
Rental and maintenance of equipment	382,158	—	—	382,158	8,488	74,208	464,854	
Communication	5,238,146	54,471	356,366	5,648,983	71,297	212,595	5,932,875	
Postage and shipping	396,887	12,524	3,175,806	3,585,217	2,105,843	1,726,409	7,417,469	
Conferences and meetings	221,782	—	2,696	224,478	105,614	46,644	376,736	
Depreciation and amortization	2,053,306	67,829	67,438	2,188,573	68,166	72,278	2,329,017	
Donation	—	—	—	—	—	—	—	
Other expenses	183,366	100,947	—	284,313	544,120	129,666	958,099	
Total	\$ 68,536,716	\$ 88,182,092	\$ 133,833,803	\$ 290,552,611	\$ 22,831,954	\$ 12,874,786	\$ 326,259,351	

Note: In-kind expenses included in supplies and services and marketing and promotion \$ 16,762,813 \$ 76,879,200 \$ 116,089,778 \$ 209,731,791 \$ — \$ — \$ 209,731,791

United Service Organizations, Inc.

Consolidated Schedule of Functional Expenses

December 31,

2009

	Program Services					Fund-raising	Management and General	Total Operating Expenses
	USO Operations	Entertainment	Communications and Public Awareness	Outreach	Total			
Salaries	\$ 13,937,775	\$ 761,205	\$ 1,048,186	\$ 15,747,166	\$ 1,775,119	\$ 3,044,786	\$ 20,567,071	
Payroll taxes	1,077,828	58,998	74,674	1,211,500	126,012	196,060	1,533,572	
Employee benefits	1,678,726	107,447	159,822	1,945,995	274,324	552,419	2,772,738	
Total salaries and related expenses	16,694,329	927,650	1,282,682	18,904,661	2,175,455	3,793,265	24,873,381	
Supplies and services	36,960,299	49,060,431	25,906	86,046,636	329,130	257,649	86,633,415	
Printing and production	65,127	2,072,004	5,933,200	8,070,331	7,576,405	2,868,886	18,515,622	
Marketing and promotion	—	221,308	82,543,405	82,764,713	637,254	—	83,401,967	
Awards and grants	615,957	—	—	615,957	—	—	615,957	
Professional fees	696,900	552,203	2,570,687	3,819,790	2,691,962	1,757,568	8,269,320	
Subscriptions, dues, and staff training	170,736	1,586	22,459	194,781	105,857	26,329	326,967	
Travel	2,116,563	2,943,704	397,927	5,458,194	407,843	270,571	6,136,608	
General insurance	280,535	22,982	30,667	334,184	44,466	104,301	482,951	
Occupancy	222,676	81,749	110,393	414,818	173,521	326,370	914,709	
Rental and maintenance of equipment	335,291	—	—	335,291	—	137,003	472,294	
Communication	2,967,209	40,383	218,171	3,225,763	43,032	218,084	3,486,879	
Postage and shipping	557,921	15,393	2,705,833	3,279,147	1,986,824	1,404,151	6,670,122	
Conferences and meetings	16,445	7,752	7,784	31,981	41,133	107,918	181,032	
Depreciation and amortization	1,349,089	40,257	40,257	1,429,603	40,257	40,257	1,510,117	
Donation	27,750	—	—	27,750	—	—	27,750	
Other expenses	277,514	70,301	—	347,815	527,533	200,294	1,075,642	
Total	\$ 63,354,341	\$ 56,057,703	\$ 95,889,371	\$ 215,301,415	\$ 16,780,672	\$ 11,512,646	\$ 243,594,733	

Note: In-kind expenses included in supplies and services and marketing and promotion

\$ 16,874,129	\$ 48,836,506	\$ 80,732,724	\$ 146,443,359	\$ —	\$ —	\$ 146,443,359
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