



MERCY SHIPS AND AFFILIATES

**CONSOLIDATED AND COMBINED
FINANCIAL STATEMENTS**
With Independent Auditors' Report

December 31, 2013

MERCY SHIPS

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Mercy Ships and Affiliates
Lindale, Texas

We have audited the accompanying consolidated and combined financial statements of Mercy Ships and Affiliates (Mercy Ships), which comprise the consolidated and combined statement of financial position as of December 31, 2013, and the related consolidated and combined statements of activities and cash flows for the year then ended, and the related notes to the consolidated and combined financial statements.

Management's Responsibility for the Consolidated and Combined Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated and combined 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 and combined financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated and combined financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated and combined financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated and combined financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated and combined financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated and combined financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated and combined financial statements.

Board of Directors
Mercy Ships and Affiliates
Lindale, Texas

Auditors' Responsibility, continued

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 and combined financial statements referred to above present fairly, in all material respects, the consolidated and combined financial position of Mercy Ships as of December 31, 2013, and the consolidated and combined 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.

Capin Crouse LLP

Dallas, Texas
May 8, 2014

MERCY SHIPS

Statement of Financial Position

December 31, 2013

ASSETS:

Cash and cash equivalents	\$ 43,908,620
Cash held for others–ship bank	1,313,947
Accounts receivable–net	475,270
Pledges receivable–net	2,913,338
Inventory	3,573,632
Other assets and surrender value of life insurance	147,004
Prepaid expenses and advances	270,742
Property and equipment–net	<u>51,943,227</u>

Total Assets \$ 104,545,780

LIABILITIES AND NET ASSETS:

Liabilities:

Accounts payable and accrued expenses	\$ 2,780,100
Ship bank payable	633,037
Deferred revenue	84,032
Notes payable	5,896,490
Capital lease obligation	<u>1,584,569</u>
Total liabilities	<u>10,978,228</u>

Net assets:

Unrestricted	58,881,801
Temporarily restricted	34,543,751
Permanently restricted	<u>142,000</u>
Total net assets	<u>93,567,552</u>

Total Liabilities and Net Assets \$ 104,545,780

See notes to consolidated and combined financial statements

MERCY SHIPS

Statement of Activities

For the Year Ended December 31, 2013

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
SUPPORT AND REVENUE:				
Contributions	\$ 23,210,367	\$ 34,347,148	\$ 30,000	\$ 57,587,515
Contributions for staff support	4,698,180	-	-	4,698,180
Gift in kind contributions	4,154,985	-	-	4,154,985
Contributed services	16,083,776	-	-	16,083,776
Fee revenue	1,754,297	-	-	1,754,297
Sales and other revenue	2,180,453	10,104	-	2,190,557
Loss from translation adjustments	(188,830)	-	-	(188,830)
Gain on sale of property and equipment	99,549	-	-	99,549
Total Support and Revenue	51,992,777	34,357,252	30,000	86,380,029
NET ASSETS RELEASED:				
Purpose restrictions	3,715,099	(3,715,099)	-	-
EXPENSES:				
Program services:				
Ship and field operations	42,429,835	-	-	42,429,835
Supporting activities:				
General and administrative	4,755,439	-	-	4,755,439
Fundraising	5,980,588	-	-	5,980,588
Total supporting activities	10,736,027	-	-	10,736,027
Total Expenses	53,165,862	-	-	53,165,862
Change in Net Assets Before Change in Cumulative Translation Adjustments	2,542,014	30,642,153	30,000	33,214,167
Cumulative Translation Adjustments	409,352	-	-	409,352
Change in Net Assets	2,951,366	30,642,153	30,000	33,623,519
Net Assets, Beginning of Year	55,930,435	3,901,598	112,000	59,944,033
Net Assets, End of Year	<u>\$ 58,881,801</u>	<u>\$ 34,543,751</u>	<u>\$ 142,000</u>	<u>\$ 93,567,552</u>

See notes to consolidated and combined financial statements

MERCY SHIPS

Statement of Cash Flows

For the Year Ended December 31, 2013

CASH FLOWS FROM OPERATING ACTIVITIES:

Change in net assets	\$ 33,623,519
Adjustments to reconcile change in net assets to net cash provided by operating activities:	
Depreciation	3,574,566
Gain on sale of property and equipment	(99,549)
Gain from translation adjustments	(220,522)
Changes in operating assets and liabilities:	
Accounts receivable–net	(19,325)
Pledges receivable–net	(2,913,338)
Inventory	(1,048,152)
Other assets and surrender value of life insurance	34,130
Prepaid expenses and advances	16,523
Accounts payable and accrued expenses	690,191
Ship bank payable	46,860
Deferred revenue	(282,791)
Net Cash Provided by Operating Activities	<u>33,402,112</u>

CASH FLOWS FROM INVESTING ACTIVITIES:

Proceeds from sale of property and equipment	100,944
Purchases of property and equipment	(1,675,106)
Net Cash Used by Investing Activities	<u>(1,574,162)</u>

CASH FLOWS FROM FINANCING ACTIVITIES:

Proceeds from notes payable	40,086
Payments on notes payable	(1,370,863)
Payments on capital lease obligations	(42,688)
Net Cash Used by Financing Activities	<u>(1,373,465)</u>

Increase in Cash and Cash Equivalents 30,454,485

Cash and Cash Equivalents and Ship Bank, Beginning of Year 14,768,082

Cash and Cash Equivalents and Ship Bank, End of Year \$ 45,222,567

SUPPLEMENTAL DISCLOSURE:

Cash paid for interest \$ 217,322

See notes to consolidated and combined financial statements

MERCY SHIPS

Notes to Consolidated and Combined Financial Statements

December 31, 2013

1. NATURE OF ORGANIZATION:

Mercy Ships (the Organization) is a ship-based international health care organization that follows the 2000 year old model of Jesus, bringing hope and healing to the world's underserved poor by mobilizing people and resources worldwide. Through its hospital ship and related healthcare and capacity building programs and partnerships, the Organization provides surgical interventions, training and capacity building and other healthcare services without regard to ethnicity, gender, political affiliation, or religious preference.

The financial statements are referred to as consolidated and combined financial statements on the cover page as well as the opinion. Consolidated and combined information is reflected in all other references to the following statements or items: financial statements, statement of financial position, statement of activities, statement of cash flows, and notes to financial statements. If any of these statements are not consolidated or combined, they will be identified accordingly. In addition, all references to Mercy Ships on these statements is a reflection of Mercy Ships and Affiliates, unless otherwise identified.

PRINCIPLES OF CONSOLIDATION

The accompanying financial statements include the accounts of Mercy Ships, Mercy Ships Associates, LLP, Mercy Ships Foundation, and Mercy Ships International, all Texas non-profit corporations, and Africa Mercy-Malta Ltd., a Maltese maritime corporation. These affiliates are under common control as defined by accounting principles generally accepted in the United States of America and are consolidated in the financial statements.

PRINCIPLES OF COMBINATION

The accompanying financial statements also include the accounts of Mercy Ships Australia Ltd., an Australian non-profit limited by Guarantee, Mercy Ships Canada Society, a Canadian non-profit corporation, Mercy Ships Deutschland e.V., a German non-profit corporation, Stichting Mercy Ships Holland, a Netherlands charitable organization, Foundation Mercy Ships-Norge, a Norwegian non-profit corporation, Association Mercy Ships, a Swiss non-profit corporation, and Mercy Ships-U.K. Ltd., a U.K. non-profit limited by Guarantee. All of these affiliates have independent boards and all exist in common ministry to fund and support the operations of the Organization. The Mercy Ships International board is a collaborative board that includes representatives from the consolidated and combined affiliates. This board does not control any one affiliate but works collaboratively to provide management and oversight for all affiliates identified. Due to lack of common board control they are not consolidated, but there is a collaborative nature of this structure so combined financial statements are presented for these affiliates.

MERCY SHIPS

Notes to Consolidated and Combined Financial Statements

December 31, 2013

1. NATURE OF ORGANIZATION, continued:

The consolidated and combined affiliates (collectively, Mercy Ships) are part of the financial statements. All material intercompany accounts and transactions have been eliminated in the financial statements. The following affiliates have been excluded from the financial statements, due to immateriality: Mercy Ships Belgium, Mercy Ships Denmark, Mercy Ships France, Mercy Ships Korea, Mercy Ships New Zealand, Mercy Ships South Africa, Mercy Ships Spain, and Mercy Ships Sweden. Mercy Ships provides funds for and receives funds from the non-combined organizations. The related revenues from and expenditures with these organizations are netted in the statement of activities within sales and other revenue.

The consolidated affiliates of Mercy Ships are non-profit religious organization under Section 501(c)(3) of the Internal Revenue Code (the Code) and is a publicly supported organization under Sections 170(b)(1) and 509(a) of the Code. They are not considered to be a private foundations under Section 509(a) of the Code.

The combined affiliates of Mercy Ships that are organized and operating outside of the United States are tax-exempt based on the various laws of the country in which they operate. These affiliates are generally not subject to any Federal or State income tax including any tax liabilities due to unrelated business income.

2. SIGNIFICANT ACCOUNTING POLICIES:

Mercy Ships maintains its accounts and prepares its financial statements on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America. The preparation of financial statements in conformity with these principles requires management to make estimates and assumptions that affect the reported amounts and disclosures at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could vary from the estimates that were assumed in preparing the financial statements. The significant accounting policies followed are described below to enhance the usefulness of the financial statements to the reader.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of checking and money market accounts. Mercy Ships considers all highly liquid investment instruments purchased with a maturity of three months or less to be cash equivalents. These accounts may, at times, exceed federally insured limits. Mercy Ships has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk on cash and cash equivalents.

CASH HELD FOR OTHERS—SHIP BANK

Mercy Ships maintains a bank on board its ship for the convenience of its crew members. The funds are shown separately on the statement of financial position. Accordingly, a corresponding liability, ship bank payable, is recorded on the statement of financial position.

MERCY SHIPS

Notes to Consolidated and Combined Financial Statements

December 31, 2013

2. SIGNIFICANT ACCOUNTING POLICIES, continued:

ACCOUNTS RECEIVABLE

Accounts receivable are presented at their net realizable value and consist of amounts resulting from operations and other transactions and are primarily due to non-U.S. offices. Allowance for doubtful accounts have been applied against accounts receivable based on estimates of uncollectible amounts. Every year management evaluates receivable balances, considers the adequacy of allowance, and makes appropriate adjustments. As of December 31, 2013, the allowance for doubtful accounts was \$4,435.

PLEDGES RECEIVABLE

Unconditional promises to give are reported as income to Mercy Ships when made and have been recorded at their pledged amounts. Pledges receivable are shown net of a discount of \$27,772 and an allowance for uncollectible receivables of \$153,334 as of December 31, 2013. Subsequent to December 31, 2013, collections on pledges receivables totaled \$538,444.

INVENTORY

Inventory consists primarily of medical supplies, food, fuel, and lubricating oil. If purchased, these items are stated at the lower of cost or market on the first-in, first-out basis. If donated, items are valued at the lower of their estimated fair market values as of the date of receipt or current market value. As of December 31, 2013, management determined no allowance for obsolete inventory was needed for the inventory on-hand.

PROPERTY AND EQUIPMENT—NET

Land, buildings, and equipment are stated at cost, or if donated, at fair value as of the date of the gift. Purchases or donations in excess of \$5,000 are capitalized with lesser amounts expensed. All capital assets, other than land, are depreciated using the straight-line method with useful lives ranging from 3-25 years.

NET ASSETS

The following classes of net assets are maintained:

Unrestricted net assets include those currently available at the discretion of Mercy Ships' board of directors for use in its associated ministries and those resources invested in property and equipment, net of any related debt.

Temporarily restricted net assets include assets of Mercy Ships related to gifts with explicit donor-imposed restrictions that have not been met as to the specified purpose or to later periods of time or after specified dates.

Permanently restricted net assets are those contributed with donor restrictions requiring they be held in perpetuity. As required by accounting principles generally accepted in the United States of America, net assets associated with endowment funds, including funds designated by management to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

MERCY SHIPS

Notes to Consolidated and Combined Financial Statements

December 31, 2013

2. SIGNIFICANT ACCOUNTING POLICIES, continued:

NET ASSETS, continued

The management of Mercy Ships has interpreted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) 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, Mercy Ships classifies as permanently restricted net assets (a) the original value of the 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 Mercy Ships in a manner consistent with the standard prudence prescribed by UPMIFA.

In accordance with UPMIFA, Mercy Ships considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

1. The duration and preservation of the fund
2. The purposes of Mercy Ships and the donor-restricted endowment fund
3. General economic conditions
4. The possible effect of inflation and deflation
5. The expected total return from income and the appreciation of investments
6. Other resources of Mercy Ships
7. The investment policies of Mercy Ships

SUPPORT, REVENUE, AND EXPENSES

Contributions are recorded when made, which may be when cash or other assets are received or unconditionally promised. Mercy Ships reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or a purpose restriction is accomplished, the associated temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as satisfaction of purpose restrictions. Support for Mercy Ships is primarily derived from contributions from individuals, church congregations, and corporations.

Mercy Ships receives various donated products such as medical, pharmaceutical supplies, and food to supply the ship. The products are donated primarily by corporations. The receipt of donated products by Mercy Ships is reflected as gift in kind contributions and the distribution is reflected as contributed goods. The donated products are valued in a manner consistent with Association of Evangelical Relief and Development Organizations Interagency Gift-in-Kind Standards.

MERCY SHIPS

Notes to Consolidated and Combined Financial Statements

December 31, 2013

2. SIGNIFICANT ACCOUNTING POLICIES, continued:

SUPPORT, REVENUE, AND EXPENSES, continued

Of the \$4,154,985 gift in kind contributions reflected in the statement of activities for the year ended December 31, 2013, 93% was used by Mercy Ships in its own programs and 7% were provided to other charities.

Contributed services are recognized if the services received require specialized skills or certifications that are provided by individuals possessing those skills and would typically need to be purchased if not provided by donation. The amount of contributed services recognized as support and expenses consisted of the following for the year ending December 31, 2013:

Program services - professional and medical	\$ 15,761,043
General and administrative support staff	202,578
Fundraising	<u>120,155</u>
	<u>\$ 16,083,776</u>

Mercy Ships also receives contributed services related to ship berthing within the ports. Due to not being able to adequately estimate the value, these contributed services are not included within the statement of activities.

Fee revenue, sales, and other revenue are recognized when earned. Fee revenue received in advance of the goods and services being provided, are recorded as deferred revenue. Expenses are reported when costs are incurred in accordance with the accrual basis of accounting.

ADVERTISING AND PROMOTIONAL COSTS

Advertising and promotional costs are expensed when they are incurred. Mercy Ships expended approximately \$900,154 promoting its mission for the year ended December 31, 2013.

UNCERTAIN TAX POSITIONS

The financial statement effects of a tax position taken or expected to be taken are recognized in the financial statements when it is more likely than not, based on the technical merits, that the position will be sustained upon examination. Interest and penalties, if any, are included in general and administrative expenses in the statement of activities. As of December 31, 2013, Mercy Ships had no uncertain tax positions that qualify for recognition or disclosure in the financial statements.

Mercy Ships' federal Exempt Organization Business Income Tax Return Form 990 is subject to examination by the Internal Revenue Service, generally for three years after it is filed. As of December 31, 2013, Mercy Ships' tax returns for the years 2010 through 2012 remain subject to examination.

MERCY SHIPS

Notes to Consolidated and Combined Financial Statements

December 31, 2013

2. SIGNIFICANT ACCOUNTING POLICIES, continued:

ALLOCATION OF EXPENSES

The costs of providing program services and supporting activities have been summarized on a functional basis in the statement of activities. Accordingly, certain costs have been allocated among the program services and supporting activities benefited.

RECLASSIFICATIONS

Certain prior year amounts have been reclassified in order to conform to current year presentation, including unrestricted net assets of \$40,000 and temporarily restricted net assets of \$72,000 reclassified to permanently restricted net assets. No adjustment was made to beginning of the year total net assets.

3. PLEDGES RECEIVABLE—NET:

Pledges receivable—net, as of December 31, 2013, consist of:

Due in less than one year	\$ 1,880,444
Due in one to five years	1,214,000
	<hr/>
	3,094,444
Less: present value discount	(27,772)
Less: allowance for uncollectible promises	(153,334)
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	\$ 2,913,338
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During the year ended December 31, 2013, Mercy Ships received new pledges receivable of \$25,750,171 from various organizations and individuals, and received payments of \$22,655,727 toward these pledges.

4. INVENTORY:

Inventory consists of the following as of December 31, 2013:

Medical supplies	\$ 2,833,876
Fuel	488,309
Food	203,081
Other	48,366
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	\$ 3,573,632
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MERCY SHIPS

Notes to Consolidated and Combined Financial Statements

December 31, 2013

5. PROPERTY AND EQUIPMENT–NET:

Property and equipment–net as of December 31, 2013, consists of:

Land and buildings	\$ 9,461,192
Ship and related improvements	68,581,337
Tools and equipment	3,974,342
Vehicles	372,318
Medical equipment	2,150,577
	<u>84,539,766</u>
Less accumulated depreciation	<u>(32,596,539)</u>
Property and equipment–net	<u>\$ 51,943,227</u>

Equity in property and equipment consists of the following:

Property and equipment–net	\$ 51,943,227
Less: notes payable secured by property	(5,896,490)
Less: capital lease obligation	<u>(1,584,569)</u>

Total equity in property and equipment \$ 44,462,168

6. NOTES PAYABLE:

Notes payable, as of December 31, 2013, consists of:

Note payable in the amount of €3,500,000, due in quarterly principal payments of €125,000 plus interest calculated at Eurobor plus 1.5%. Note matures April 2018 and is secured by property. \$ 2,925,700

Note payable in the amount of €3,500,000, due in quarterly principal payments of €125,000 plus interest calculated at Eurobor plus 1.5%. Note matures April 2018 and is secured by property. 2,925,700

Various other secured and unsecured notes 45,090

\$ 5,896,490

MERCY SHIPS

Notes to Consolidated and Combined Financial Statements

December 31, 2013

6. NOTES PAYABLE, continued:

Based on currency exchange rates as of December 31, 2013, the aggregate maturities of notes payable for each of the subsequent years are:

<u>Year Ending December 31,</u>	
2014	\$ 1,421,890
2015	1,376,800
2016	1,376,800
2017	1,376,800
2018	<u>344,200</u>
	<u>\$ 5,896,490</u>

Mercy Ships was in compliance with, or had received waivers for, all financial and reporting covenants at December 31, 2013.

7. CAPITAL LEASE OBLIGATION:

Mercy Ships entered into an eighty year land lease commitment with the City of Lausanne, Switzerland, effective February 9, 1994, and continuing until February 17, 2074. This lease meets the criteria for capitalization and is therefore recorded in the accompanying statement of financial position as an asset, and the related obligation is recorded at the present value of future minimum lease payments. Concurrent with the land lease obligation, the City of Lausanne gifted ownership of a building named Maison de Rovereaz to Mercy Ships. Mercy Ships agreed to lease, maintain, and renovate the building to current standards. The land lease provides for a cost of living increase every three years based on the Swiss consumer price index.

The present value of future minimum lease payments was calculated using an implicit borrowing rate of 7.0% per annum. As of December 31, 2013, the total lease obligation included accrued interest of \$779,272.

Land and building of CHF 750,000 (\$842,475 as of December 31, 2013) has been capitalized under the lease agreement and accumulated depreciation for the year ended December 31, 2013 was CHF 187,500 (\$210,619).

MERCY SHIPS

Notes to Consolidated and Combined Financial Statements

December 31, 2013

7. CAPITAL LEASE OBLIGATION, continued:

The future minimum lease payments required under this capital lease are:

<u>Year Ending December 31,</u>	
2014	\$ 64,540
2015	71,199
2016	71,199
2017	71,199
2018	78,550
Thereafter	448,610
	<hr/> 805,297
Accrued interest	779,272
	<hr/> <hr/> \$ 1,584,569

8. UNRESTRICTED NET ASSETS:

Unrestricted net assets, as of December 31, 2013, consist of:

Available for operations	\$ 10,832,297
Equity in property and equipment-net	44,462,168
Equity in inventory-net	3,573,632
Quasi endowments	13,704
	<hr/>
	\$ 58,881,801

9. TEMPORARILY RESTRICTED NET ASSETS:

Temporarily restricted net assets as of December 31, 2013 consist of:

Capital project-new ship	\$ 26,136,270
Capital project-pledges	2,913,338
M/V Africa Mercy	2,263,496
Maxillofacial/plastic surgery projects	672,370
Mercy vision projects	565,513
Non-surgical projects	461,414
Vesicovaginal fistula projects	372,018
Orthopedic projects	237,526
General surgery projects	221,646
Dental projects	206,696
Other ministry projects	493,464
	<hr/>
	\$ 34,543,751

MERCY SHIPS

Notes to Consolidated and Combined Financial Statements

December 31, 2013

10. ENDOWMENT FUNDS AND RELATED ASSETS:

Assets held for endowment fund as of December 31, 2013 consist of:

Cash and cash equivalents	\$ 168,810
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Permanently restricted net assets as of December 31, 2013 consist of:

Crew assistance fund	\$ 82,000
Operations	60,000
	\$ 142,000

The endowment net asset composition by type of fund as of December 31, 2013:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor restricted endowment funds	\$ 13,704	\$ 13,106	\$ 142,000	\$ 168,810

Changes in endowment net assets for the year ended December 31, 2013:

Endowment net assets, beginning of year	\$ 7,947	\$ 3,002	\$ 112,000	\$ 122,949
Investment income	5,757	10,104	-	15,861
Contributions	-	-	30,000	30,000
	\$ 13,704	\$ 13,106	\$ 142,000	\$ 168,810

From time to time, the fair value of assets associated with individual donor restricted endowment funds may fall below the level that the donor or UPMIFA requires Mercy Ships to retain as a fund of perpetual duration. In accordance with accounting principles generally accepted in the United States of America, deficiencies of this nature are reported in unrestricted net assets. As of December 31, 2013, there are no deficiencies resulting from unfavorable market fluctuations.

MERCY SHIPS

Notes to Consolidated and Combined Financial Statements

December 31, 2013

11. FAIR VALUE MEASUREMENTS:

Mercy Ships has a number of financial instruments, consisting of: accounts receivable, pledges receivable, other current assets, notes payable, capital lease obligation, and other current liabilities. None of the financial instruments are held for trading purposes. Mercy Ships estimates the fair value of these financial instruments as of December 31, 2013, and the estimated fair value does not materially differ from the aggregate carrying values of its financial instruments reflected in the accompanying statement of financial position.

12. DEFINED CONTRIBUTION PENSION PLAN:

Mercy Ships provides a 403(b) defined contribution retirement plan to eligible employees. All full-time employees are eligible to participate after a three-month probationary period. Eligible employees can contribute pre-tax elective deferrals up to 100% of compensation. After reaching age 59 1/2 the employee may receive lump-sum distributions up to 100% vested balance. Mercy Ships did not make any contributions to the plan for the year ended December 31, 2013.

13. TRANSFERS FROM AFFILIATES:

Mercy Ships' international affiliates are certified by various charity boards within their countries. To satisfy requirements of these boards, the following information is presented for the purpose of disclosing the amount of funds transferred from each affiliate and disbursed to pay for program and ship operational expenses and long term liabilities of Mercy Ships. These amounts are considered intercompany transactions for the purposes of the financial statements and are therefore eliminated upon combination.

The amount of funds transferred from the affiliates during the year ended December 31, 2013 was as follows:

Australia	\$	245,958
Canada		598,279
Germany		1,141,576
Holland		2,731,011
Norway		661,340
Switzerland		4,072,713
United Kingdom		4,313,149
		<hr/>
	\$	13,764,026
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MERCY SHIPS

Notes to Consolidated and Combined Financial Statements

December 31, 2013

14. NON-U.S. OPERATIONS:

Mercy Ships' international affiliates are located in various countries. Non-U.S. operations are subject to risks inherent in operating under different legal systems and various political and economic environments. Among the risks are changes in existing tax laws, possible limitations on non-U.S. investment and income repatriation, government price or non-U.S. exchange controls, and restrictions on currency exchange. For the year ended December 31, 2013, net assets of non-U.S. operations were 9.5% of Mercy Ships' total net assets.

Most of Mercy Ships' international affiliates use the local currency as the functional currency. The financial statements of Mercy Ships' international affiliates have been translated into U.S. dollars. The statement of financial position accounts have been translated using the exchange rate in effect at the statement of financial position date. Statement of activities amounts have been translated using the average exchange rate for the year. These adjustments for the year ended December 31, 2013, are reflected accordingly on the statement of activities.

As of the report date, there continues to be fluctuations in the value of the U.S. dollar relative to several non-U.S. currencies in which Mercy Ships operates. It is not practicable to determine the effects of these rate changes on Mercy Ships' financial statements.

15. SUBSEQUENT EVENTS:

Subsequent events have been evaluated through the report date, which represents the date the financial statements were available to be issued. Subsequent events after that date have not been evaluated.