



## **MERCY SHIPS AND AFFILIATES**

Consolidated And Combined  
Financial Statements  
With Independent Auditors' Report

December 31, 2015 and 2014

# MERCY SHIPS AND AFFILIATES

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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, which comprise the consolidated and combined statements of financial position as of December 31, 2015 and 2014, and the related consolidated and combined statements of activities and cash flows for the years 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 audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits 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 and Affiliates as of December 31, 2015 and 2014, and the consolidated and combined changes in their net assets and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*Capin Crouse LLP*

Dallas, Texas  
May 2, 2016

# MERCY SHIPS AND AFFILIATES

## Consolidated and Combined Statements of Financial Position

	December 31,	
	2015	2014
<b>ASSETS:</b>		
Cash and cash equivalents	\$ 41,954,996	\$ 47,673,513
Cash held for others—ship bank	945,465	1,467,849
Certificate of deposit	12,063,441	-
Accounts receivable—net	829,795	840,792
Pledges receivable—net	27,886,663	18,339,627
Inventory	3,307,691	3,818,767
Other assets and surrender value of life insurance	183,602	164,428
Prepaid expenses and advances	199,024	224,971
Property and equipment—net	73,118,986	61,698,985
Total Assets	\$ 160,489,663	\$ 134,228,932
<b>LIABILITIES AND NET ASSETS:</b>		
Liabilities:		
Accounts payable and accrued expenses	\$ 7,490,051	\$ 4,119,463
Ship bank payable	1,067,120	849,880
Deferred revenue	85,406	707,914
Notes payable	3,026,122	3,979,631
Capital lease obligation	1,507,024	1,474,370
Total liabilities	13,175,723	11,131,258
Net assets:		
Unrestricted	82,890,546	72,324,506
Temporarily restricted	63,841,394	50,401,168
Permanently restricted	582,000	372,000
Total net assets	147,313,940	123,097,674
Total Liabilities and Net Assets	\$ 160,489,663	\$ 134,228,932

See notes to consolidated and combined financial statements

# MERCY SHIPS AND AFFILIATES

## Consolidated and Combined Statements of Activities

	Year Ended December 31,				
	2015			2014	
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Total
<b>SUPPORT AND REVENUE:</b>					
Contributions	\$ 31,433,878	\$ 32,428,928	\$ 210,000	\$ 64,072,806	\$ 65,446,702
Contributions for staff support	4,905,489	-	-	4,905,489	4,610,804
Gift in kind contributions	2,575,111	-	-	2,575,111	4,793,211
Contributed services	17,542,814	-	-	17,542,814	15,790,787
Fee revenue	1,864,192	-	-	1,864,192	1,628,746
Sales and other revenue	2,005,308	3,329	-	2,008,637	1,726,105
Gain (loss) from translation adjustments	82,493	-	-	82,493	(15,232)
Gain (loss) on sale of property and equipment	(6,879)	-	-	(6,879)	25,131
<b>Total Support and Revenue</b>	<b>60,402,406</b>	<b>32,432,257</b>	<b>210,000</b>	<b>93,044,663</b>	<b>94,006,254</b>
<b>NET ASSETS RELEASED:</b>					
Purpose restrictions	18,992,031	(18,992,031)	-	-	-
<b>EXPENSES:</b>					
Program services:					
Ship and field operations	50,287,474	-	-	50,287,474	48,563,099
Supporting activities:					
General and administrative	5,151,427	-	-	5,151,427	5,564,231
Fundraising	11,519,070	-	-	11,519,070	9,041,767
<b>Total supporting activities</b>	<b>16,670,497</b>	<b>-</b>	<b>-</b>	<b>16,670,497</b>	<b>14,605,998</b>
<b>Total Expenses</b>	<b>66,957,971</b>	<b>-</b>	<b>-</b>	<b>66,957,971</b>	<b>63,169,097</b>
Change in Net Assets Before Change in Cumulative Translation Adjustments	12,436,466	13,440,226	210,000	26,086,692	30,837,157
Cumulative Translation Adjustments	(1,870,426)	-	-	(1,870,426)	(1,307,035)
Change in Net Assets	10,566,040	13,440,226	210,000	24,216,266	29,530,122
Net Assets, Beginning of Year	72,324,506	50,401,168	372,000	123,097,674	93,567,552
Net Assets, End of Year	\$ 82,890,546	\$ 63,841,394	\$ 582,000	\$ 147,313,940	\$ 123,097,674

See notes to consolidated and combined financial statements

# MERCY SHIPS AND AFFILIATES

## Consolidated and Combined Statements of Cash Flows

	December 31,	
	2015	2014
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Change in net assets	\$ 24,216,266	\$ 29,530,122
Adjustments to reconcile change in net assets to net cash provided(used) by operating activities:		
Depreciation	3,546,603	3,617,652
(Gain) loss on sale of property and equipment	868	(22,829)
Gain from translation adjustments	(129,555)	(364,239)
Changes in operating assets and liabilities:		
Accounts receivable–net	10,997	(365,522)
Pledges receivable–net	(9,547,036)	(15,426,289)
Inventory	511,076	(245,135)
Other assets and surrender value of life insurance	(19,174)	(17,424)
Prepaid expenses and advances	25,947	45,771
Accounts payable and accrued expenses	2,894,076	1,239,363
Ship bank payable	217,240	216,843
Deferred revenue	(622,508)	623,882
Net Cash Provided by Operating Activities	21,104,800	18,832,195
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Proceeds from sale of property and equipment	4,829	22,829
Purchases of certificates of deposit	(12,063,441)	-
Purchases of property and equipment	(14,487,766)	(13,537,956)
Net Cash Used by Investing Activities	(26,546,378)	(13,515,127)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from notes payable	567,548	-
Payments on notes payable	(1,303,024)	(1,351,891)
Payments on capital lease obligations	(63,847)	(46,382)
Net Cash Used by Financing Activities	(799,323)	(1,398,273)
Increase in Cash and Cash Equivalents	(6,240,901)	3,918,795
Cash and Cash Equivalents and Ship Bank, Beginning of Year	49,141,362	45,222,567
Cash and Cash Equivalents and Ship Bank, End of Year	\$ 42,900,461	\$ 49,141,362
<b>SUPPLEMENTAL DISCLOSURE:</b>		
Cash paid for interest	\$ 159,872	\$ 199,258
Property and equipment capitalized, not yet paid for	\$ 476,512	\$ 100,000

See notes to consolidated and combined financial statements

# MERCY SHIPS AND AFFILIATES

## Notes to Consolidated and Combined Financial Statements

December 31, 2015 and 2014

### 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, Community of Faith, LLC, 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 Belgium VZW, a Belgium non-profit corporation, 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, Mercy Ships Global Association, a Swiss non-profit association and Mercy Ships-U.K. Ltd., a U.K. non-profit limited by Guarantee. All of these affiliates operate independently with their own separate boards of directors and work together collaboratively to achieve their respective charitable purposes. The Mercy Ships International board is a collaborative board that includes representatives from both the consolidated and combined affiliates. This board does not control any one affiliate but rather works collaboratively with them to ensure that their respective charitable programs are carried out in a consistent and co-ordinated manner with those of Mercy Ships International and one another, subject to the applicable laws of their originating jurisdictions. Due to lack of common board control, these affiliates are not consolidated with Mercy Ships International. However, given the collaborative nature of this structure, combined financial statements are presented for these affiliates.



# MERCY SHIPS AND AFFILIATES

## Notes to Consolidated and Combined Financial Statements

December 31, 2015 and 2014

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 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 organizations under Section 501(c)(3) of the Internal Revenue Code (the Code) and are publicly supported organizations under Sections 170(b)(1) and 509(a) of the Code. They are not considered to be 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 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, disclosures of any contingent assets and liabilities at the date of the financial statements, and the reported revenues and expenses during the reporting periods. Actual results could differ from the estimates. 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.

### CERTIFICATE OF DEPOSIT

Mercy Ships maintains a certificate of deposit with an original maturity date exceeding 90 days. The certificate is recorded at cost plus accrued interest.

# MERCY SHIPS AND AFFILIATES

## Notes to Consolidated and Combined Financial Statements

December 31, 2015 and 2014

### 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, 2015 and 2014, the allowance for doubtful accounts was \$7,259 and \$4,435, respectively.

#### 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 \$256,039 and \$163,703, respectively, and an allowance for uncollectible receivables of \$1,467,719 and \$965,244, respectively, as of December 31, 2015 and 2014. Subsequent to December 31, 2015, collections on pledges receivables totaled \$656,500.

#### 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, 2015 and 2014, 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 \$25,000 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. Assets not placed into service consist of capital expenditures for the new ship that are currently not being depreciated, however, will be depreciated based on the Organization's depreciation policy, once these assets are operable.

#### 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 AND AFFILIATES

## Notes to Consolidated and Combined Financial Statements

December 31, 2015 and 2014

### 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 and 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 AND AFFILIATES

## Notes to Consolidated and Combined Financial Statements

December 31, 2015 and 2014

### 2. SIGNIFICANT ACCOUNTING POLICIES, continued:

#### SUPPORT, REVENUE, AND EXPENSES, continued

Of the \$2,575,111 and \$4,793,211 gift in kind contributions reflected in the statement of activities for the years ended December 31, 2015 and 2014, respectively, 99% and 96% was used by Mercy Ships in its own programs and 1% and 4% were provided to other charities, respectively.

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:

	December 31,	
	2015	2014
Program services - professional and medical	\$ 17,219,355	\$ 15,502,542
General and administrative support staff	230,925	197,637
Fundraising	92,534	90,608
	<u>\$ 17,542,814</u>	<u>\$ 15,790,787</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 \$4,775,005 and \$2,616,127 promoting its mission for the years ended December 31, 2015 and 2014, respectively.

#### 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, 2015, 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, 2015, Mercy Ships' tax returns for the years 2012 through 2014 remain subject to examination.

# MERCY SHIPS AND AFFILIATES

## Notes to Consolidated and Combined Financial Statements

December 31, 2015 and 2014

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.

3. PLEDGES RECEIVABLE—NET:

Pledges receivable—net, consist of:

	December 31,	
	2015	2014
Due in less than one year	\$ 13,164,921	\$ 8,994,073
Due in one to five years	16,445,500	10,474,500
	<u>29,610,421</u>	<u>19,468,573</u>
Less: present value discount	(256,039)	(163,703)
Less: allowance for uncollectible promises	(1,467,719)	(965,243)
	<u>\$ 27,886,663</u>	<u>\$ 18,339,627</u>

During the years ended December 31, 2015 and 2014, Mercy Ships received new pledges receivable of \$21,270,000 and \$20,414,446, approximately \$20,000,000 of these pledges being from board members, and received payments of \$11,027,504 and \$4,040,317, respectively, toward these pledges.

4. INVENTORY:

Inventory consists of the following:

	December 31,	
	2015	2014
Medical supplies	\$ 2,751,913	\$ 2,834,289
Fuel	331,994	669,654
Food	176,905	259,098
Other	46,879	55,726
	<u>\$ 3,307,691</u>	<u>\$ 3,818,767</u>

# MERCY SHIPS AND AFFILIATES

## Notes to Consolidated and Combined Financial Statements

December 31, 2015 and 2014

5. PROPERTY AND EQUIPMENT—NET:

Property and equipment consists of:

	December 31,	
	2015	2014
Land and buildings	\$ 9,470,190	\$ 8,894,893
Ship and related improvements	67,110,403	66,965,571
Tools and equipment	3,434,431	3,050,386
Vehicles	1,435,768	1,394,977
Medical equipment	2,345,228	2,345,228
	83,796,020	82,651,055
Less accumulated depreciation	(39,162,924)	(35,727,055)
	44,633,096	46,924,000
Assets not placed into service	28,485,890	14,774,985
	\$ 73,118,986	\$ 61,698,985
Equity in property and equipment consists of the following:		
Property and equipment—net	\$ 73,118,986	\$ 61,698,985
Less: notes payable secured by property	(3,026,122)	(3,979,631)
Less: capital lease obligation	(1,507,024)	(1,474,370)
	\$ 68,585,840	\$ 56,244,984

# MERCY SHIPS AND AFFILIATES

## Notes to Consolidated and Combined Financial Statements

December 31, 2015 and 2014

6. NOTES PAYABLE:

Notes payable consists of:

	December 31,	
	2015	2014
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.	\$ 1,229,287	\$ 1,975,350
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.	1,229,287	1,975,350
Note payable in the amount of €500,000, due in annual principal payments of €33,333, plus interest of 3%. Note matures December 2030.	545,300	-
Various other secured and unsecured notes	22,248	28,931
	\$ 3,026,122	\$ 3,979,631

Based on currency exchange rates as of December 31, 2015, the aggregate maturities of notes payable for each of the subsequent years are:

Year Ending December 31,

2016	\$ 1,132,761
2017	1,132,761
2018	313,236
2019	40,061
2020	40,061
Thereafter	367,242
	\$ 3,026,122

Mercy Ships was in compliance with, or had received waivers for, all financial and reporting covenants at December 31, 2015 and 2014.

# MERCY SHIPS AND AFFILIATES

## Notes to Consolidated and Combined Financial Statements

December 31, 2015 and 2014

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, 2015 and 2014, the total lease obligation included accrued interest of \$781,126 and \$743,996, respectively.

For both the years ended December 31, 2015 and 2014, land and buildings of CHF 750,000 (\$755,475 and \$758,025, respectively, as of December 31, 2015 and 2014) has been capitalized under the lease agreement and accumulated depreciation for the years ended December 31, 2015 and 2014, was CHF 206,250 and CHF 196,875, respectively, (\$207,756 and \$198,982, respectively).

The future minimum lease payments required for capital leases are:

Year Ending December 31,

2016	\$	65,101
2017		65,101
2018		71,692
2019		70,438
2020		70,438
Thereafter		383,128
		<hr/>
		725,898
Accrued interest		781,126
		<hr/>
	\$	1,507,024
		<hr/>



# MERCY SHIPS AND AFFILIATES

## Notes to Consolidated and Combined Financial Statements

December 31, 2015 and 2014

### 8. UNRESTRICTED NET ASSETS:

Unrestricted net assets consist of:

	December 31,	
	2015	2014
Available for operations	\$ 10,982,891	\$ 12,246,882
Equity in property and equipment–net	68,585,840	56,244,984
Equity in inventory–net	3,307,691	3,818,767
Quasi endowments	14,124	13,873
	<u>\$ 82,890,546</u>	<u>\$ 72,324,506</u>

### 9. TEMPORARILY RESTRICTED NET ASSETS:

Temporarily restricted net assets consist of:

	December 31,	
	2015	2014
Capital project–new ship:		
Funds received, not spent	\$ 24,807,491	\$ 23,870,568
Pledges made, not received	27,886,663	18,339,627
	<u>52,694,154</u>	<u>42,210,195</u>
M/V Africa Mercy	4,900,563	4,436,818
Maxillofacial/plastic surgery projects	1,724,916	920,494
Mercy vision projects	1,009,864	962,466
Women's health projects	852,686	358,359
Non-surgical projects	535,556	209,130
Orthopedic projects	425,665	182,844
General surgery projects	419,290	52,708
Dental projects	410,815	144,343
Crew Assistance Fund	344,115	618,360
Other ministry projects	523,770	305,451
	<u>\$ 63,841,394</u>	<u>\$ 50,401,168</u>

# MERCY SHIPS AND AFFILIATES

## Notes to Consolidated and Combined Financial Statements

December 31, 2015 and 2014

10. ENDOWMENT FUNDS AND RELATED ASSETS:

Assets held for endowment fund consist of:

	December 31,	
	2015	2014
Cash and cash equivalents	\$ 620,609	\$ 407,029

Permanently restricted net assets consist of:

	December 31,	
	2015	2014
Crew assistance fund	\$ 102,000	\$ 92,000
Operations	80,000	80,000
Technical training	400,000	200,000
	\$ 582,000	\$ 372,000

The endowment net asset composition by type of fund as of December 31, 2015:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor restricted endowment funds	\$ 14,124	\$ 24,485	\$ 582,000	\$ 620,609

Changes in endowment net assets for the year ended December 31, 2014:

Endowment net assets, beginning of year	\$ 13,873	\$ 21,156	\$ 372,000	\$ 407,029
Investment income	251	3,329	-	3,580
Contributions	-	-	210,000	210,000
Endowment net assets, end of year	\$ 14,124	\$ 24,485	\$ 582,000	\$ 620,609

# MERCY SHIPS AND AFFILIATES

## Notes to Consolidated and Combined Financial Statements

December 31, 2015 and 2014

10. ENDOWMENT FUNDS AND RELATED ASSETS, continued:

The endowment net asset composition by type of fund as of December 31, 2014:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor restricted endowment funds	\$ 13,873	\$ 21,156	\$ 372,000	\$ 407,029

Changes in endowment net assets for the year ended December 31, 2014:

Endowment net assets, beginning of year	\$ 13,704	\$ 13,106	\$ 142,000	\$ 168,810
Investment income	169	8,050	-	8,219
Contributions	-	-	230,000	230,000
Endowment net assets, end of year	<u>\$ 13,873</u>	<u>\$ 21,156</u>	<u>\$ 372,000</u>	<u>\$ 407,029</u>

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, 2015 and 2014, there are no deficiencies resulting from unfavorable market fluctuations, respectively.

# MERCY SHIPS AND AFFILIATES

## Notes to Consolidated and Combined Financial Statements

December 31, 2015 and 2014

### 11. FAIR VALUE MEASUREMENTS:

Mercy Ships has a number of financial instruments, consisting of: certificate of deposit, 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 both December 31, 2015 and 2014, 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 in the years ended December 31, 2015 and 2014.

### 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 was as follows:

	December 31,	
	2015	2014
Australia	\$ 1,528,140	\$ 392,135
Belgium	1,432,883	1,898,572
Canada	250,083	605,944
Germany	1,209,113	1,470,194
Holland	2,096,844	2,657,258
Norway	587,358	904,928
Switzerland	7,364,761	1,493,863
United Kingdom	3,901,321	6,915,425
	<u>\$ 18,370,503</u>	<u>\$ 16,338,319</u>

# MERCY SHIPS AND AFFILIATES

## Notes to Consolidated and Combined Financial Statements

December 31, 2015 and 2014

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 years ended December 31, 2015 and 2014, net assets of non-U.S. operations were 6.7% and 9.0% of Mercy Ships' total net assets, respectively.

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 years ended December 31, 2015 and 2014, 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 consolidated and combined financial statements were available to be issued. Subsequent events after that date have not been evaluated.