



MERCY SHIPS AND AFFILIATES

Consolidated and Combined
Financial Statements
With Independent Auditors' Report

December 31, 2017 and 2016

MERCY SHIPS AND AFFILIATES

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Mercy Ships and Affiliates
Lindale, Texas

Report on the Consolidated and Combined Financial Statements

We have audited the accompanying consolidated and combined financial statements of Mercy Ships and Affiliates, which comprise the consolidated and combined statement of financial position as of December 31, 2017, 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 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.

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

Board of Directors
Mercy Ships and Affiliates
Lindale, Texas

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, 2017, 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.

Report on Summarized Comparative Information

We have previously audited Mercy Ships and Affiliates' 2016 consolidated and combined financial statements, and we expressed an unmodified audit opinion on those audited consolidated and combined financial statements in our report dated May 1, 2017. In our opinion, the summarized comparative information presented herein as of and for the year ended December 31, 2016, is consistent, in all material respects, with the audited consolidated and combined financial statements from which it has been derived.

Capin Crouse LLP

Grapevine, Texas
May 11, 2018

MERCY SHIPS AND AFFILIATES

Consolidated and Combined Statements of Financial Position

December 31, 2017

With Summarized Financial Information for December 31, 2016

	2017	2016
ASSETS:		
Cash and cash equivalents	\$ 30,588,569	\$ 29,448,696
Cash held for others—ship bank	1,428,030	878,072
Certificate of deposit	12,308,955	12,180,443
Accounts receivable—net	1,257,540	929,945
Pledges receivable—net	42,559,505	24,993,070
Inventory	3,258,214	3,138,498
Other assets and surrender value of life insurance	204,431	189,596
Prepaid expenses and advances	1,250,674	546,835
Cash and cash equivalents held for long-term purposes	30,637,369	25,828,089
Property and equipment—net	89,809,161	84,747,667
Total Assets	\$ 213,302,448	\$ 182,880,911
LIABILITIES AND NET ASSETS:		
Liabilities:		
Accounts payable and accrued expenses	\$ 6,391,666	\$ 4,530,423
Ship bank payable	1,080,656	984,454
Deferred revenue	93,358	59,129
Notes payable	542,012	1,832,373
Capital lease obligation	1,622,728	1,510,548
	9,730,420	8,916,927
Net assets:		
Unrestricted	111,554,852	99,610,243
Temporarily restricted	91,030,176	73,566,741
Permanently restricted	987,000	787,000
	203,572,028	173,963,984
Total Liabilities and Net Assets	\$ 213,302,448	\$ 182,880,911

See notes to consolidated and combined financial statements

MERCY SHIPS AND AFFILIATES

Consolidated and Combined Statements of Activities

For the Year Ended December 31, 2017

With Summarized Financial Information for the Year Ended December 31, 2016

	Unrestricted	Temporarily Restricted	Permanently Restricted	2017 Total	2016 Total
SUPPORT AND REVENUE:					
Contributions	\$ 44,398,964	\$ 33,297,799	\$ 200,000	\$ 77,896,763	\$ 65,852,082
Contributions for staff support	4,183,293	-	-	4,183,293	4,446,365
Gift-in-kind contributions	7,717,140	-	-	7,717,140	3,858,697
Contributed services	17,535,208	-	-	17,535,208	16,944,661
Fee revenue	1,789,286	-	-	1,789,286	1,739,159
Sales and other revenue	1,712,958	14,480	-	1,727,438	2,182,306
Gain (loss) from translation adjustments	886,444	-	-	886,444	(1,156,509)
Total Support and Revenue	78,223,293	33,312,279	200,000	111,735,572	93,866,761
NET ASSETS RELEASED:					
Purpose restrictions	15,848,844	(15,848,844)	-	-	-
EXPENSES:					
Program services:					
Ship and field operations	62,227,252	-	-	62,227,252	51,804,877
Supporting activities:					
General and administrative	6,760,813	-	-	6,760,813	5,298,657
Fundraising	13,831,041	-	-	13,831,041	11,641,655
	20,591,854	-	-	20,591,854	16,940,312
Total Expenses	82,819,106	-	-	82,819,106	68,745,189
Change in Net Assets Before Change in Cumulative Translation Adjustments	11,253,031	17,463,435	200,000	28,916,466	25,121,572
Cumulative Translation Adjustments	691,578	-	-	691,578	1,528,472
Change in Net Assets	11,944,609	17,463,435	200,000	29,608,044	26,650,044
Net Assets, Beginning of Year	99,610,243	73,566,741	787,000	173,963,984	147,313,940
Net Assets, End of Year	<u>\$ 111,554,852</u>	<u>\$ 91,030,176</u>	<u>\$ 987,000</u>	<u>\$ 203,572,028</u>	<u>\$ 173,963,984</u>

See notes to consolidated and combined financial statements

MERCY SHIPS AND AFFILIATES

Consolidated and Combined Statements of Cash Flows

For the Year Ended December 31, 2017

With Summarized Financial Information for the Year Ended December 31, 2016

	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:		
Change in net assets	\$ 29,608,044	\$ 26,650,044
Adjustments to reconcile change in net assets to net cash provided (used) by operating activities:		
Depreciation	3,843,935	3,613,911
(Gain) loss on sale of property and equipment	2,474	(62,624)
Gain from translation adjustments	(691,578)	(1,528,472)
Contributions received for long-term purposes	(25,186,674)	(22,369,539)
Changes in operating assets and liabilities:		
Accounts receivable–net	(327,595)	(100,150)
Pledges receivable–net	(17,566,435)	2,893,593
Inventory	(119,716)	169,193
Other assets and surrender value of life insurance	(14,835)	(5,994)
Prepaid expenses and advances	(703,839)	(347,811)
Accounts payable and accrued expenses	1,861,243	(3,142,203)
Ship bank payable	96,202	(82,666)
Deferred revenue	34,229	(26,277)
Net Cash Provided (Used) by Operating Activities	<u>(9,164,545)</u>	<u>5,661,005</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sale of property and equipment	-	67,961
Purchases of certificates of deposit	(128,512)	(117,002)
Purchases of property and equipment	(8,583,540)	(15,168,275)
Net Cash Used by Investing Activities	<u>(8,712,052)</u>	<u>(15,217,316)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from contributions for long-term purposes	7,471,316	13,272,118
Transfers of cash received for long-term purposes	12,906,078	9,097,421
Payments on notes payable	(1,360,955)	(1,138,435)
Payments on capital lease obligations	(64,408)	(42,834)
Net Cash Provided by Financing Activities	<u>18,952,031</u>	<u>21,188,270</u>
Effect of Exchange Rate Changes on Cash	<u>614,397</u>	<u>1,622,437</u>
Change in Cash and Cash Equivalents	1,689,831	13,254,396
Cash and Cash Equivalents and Ship Bank, Beginning of Year	<u>30,326,768</u>	<u>17,072,372</u>
Cash and Cash Equivalents and Ship Bank, End of Year	32,016,599	30,326,768
Cash held for long-term purposes	<u>30,637,369</u>	<u>25,828,089</u>
Total Cash and Cash Equivalents, End of Year	<u>\$ 62,653,968</u>	<u>\$ 56,154,857</u>
SUPPLEMENTAL DISCLOSURE:		
Cash paid for interest	<u>\$ 139,136</u>	<u>\$ 150,829</u>
Property and equipment capitalized, not yet paid for	<u>\$ -</u>	<u>\$ 182,575</u>

See notes to consolidated and combined financial statements

MERCY SHIPS AND AFFILIATES

Notes to Consolidated and Combined Financial Statements

December 31, 2017

December 31, 2016 (Summarized Financial Information)

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, statements of financial position, statements of activities, statements 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 nonprofit 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 nonprofit limited by Guarantee, Mercy Ships Belgium VZW, a Belgium nonprofit corporation, Mercy Ships Canada Society, a Canadian nonprofit corporation, Mercy Ships Deutschland e.V., a German nonprofit corporation, Stichting Mercy Ships Holland, a Netherlands charitable organization, Foundation Mercy Ships-Norge, a Norwegian nonprofit corporation, Association Mercy Ships, a Swiss nonprofit corporation, Mercy Ships Global Association, a Swiss nonprofit association and Mercy Ships-U.K. Ltd., a U.K. nonprofit 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 coordinated 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, these affiliates are included in these financial statements on a combined basis.

MERCY SHIPS AND AFFILIATES

Notes to Consolidated and Combined Financial Statements

December 31, 2017

December 31, 2016 (Summarized Financial Information)

1. NATURE OF ORGANIZATION, continued:

The consolidated and combined affiliates (collectively, Mercy Ships) are part of the consolidated and combined financial statements. All material intercompany accounts and transactions have been eliminated in the consolidated and combined 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 consolidated and combined statements of activities within sales and other revenue.

The consolidated affiliates of Mercy Ships are nonprofit 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 consolidated and combined financial statements on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America. The preparation of the consolidated and combined 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 consolidated and combined 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 consolidated and combined 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 an original 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.

At December 31, 2017 and 2016, Mercy Ship's cash balances exceeded federally insured limits by \$59,152,681 and \$54,696,087, respectively. Mercy Ships does not believe these funds to be at substantial risk of loss due to the lack of federal insurance coverage.

MERCY SHIPS AND AFFILIATES

Notes to Consolidated and Combined Financial Statements

December 31, 2017

December 31, 2016 (Summarized Financial Information)

2. SIGNIFICANT ACCOUNTING POLICIES, continued:

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 consolidated and combined statements of financial position. Accordingly, a corresponding liability, ship bank payable, is recorded on the consolidated and combined statements 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.

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, 2017 and 2016, the allowance for doubtful accounts was \$4,464 and \$9,055, respectively.

PLEDGES RECEIVABLE

Unconditional promises to give are reported as income to Mercy Ships when made and have been recorded at their pledged amounts. Subsequent to December 31, 2017, collections on pledges receivables totaled \$5,333,865.

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, 2017 and 2016, 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.

MERCY SHIPS AND AFFILIATES

Notes to Consolidated and Combined Financial Statements

December 31, 2017

December 31, 2016 (Summarized Financial Information)

2. SIGNIFICANT ACCOUNTING POLICIES, continued:

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.

The management of Mercy Ships has interpreted the Texas Uniform Prudent Management of Institutional Funds Act (TUPMIFA) 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 TUPMIFA.

In accordance with TUPMIFA, 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

MERCY SHIPS AND AFFILIATES

Notes to Consolidated and Combined Financial Statements

December 31, 2017

December 31, 2016 (Summarized Financial Information)

2. SIGNIFICANT ACCOUNTING POLICIES, continued:

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 consolidated and combined statements 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.

Of the \$7,704,377 and \$3,858,697 gift-in-kind contributions reflected in the consolidated and combined statements of activities for the years ended December 31, 2017 and 2016, respectively, 98% and 100% was used by Mercy Ships in its own programs and 2% and 0% 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,	
	2017	2016
Program services—professional and medical	\$ 17,489,014	\$ 16,872,501
General and administrative support staff	40,250	47,615
Fundraising	5,944	24,545
	<u>\$ 17,535,208</u>	<u>\$ 16,944,661</u>

Mercy Ships also receives contributed services related to ship berthing within the ports. Due to such services not meeting the requirement for recording under GAAP, these contributed services are not included within the consolidated and combined statements of activities.

MERCY SHIPS AND AFFILIATES

Notes to Consolidated and Combined Financial Statements

December 31, 2017

December 31, 2016 (Summarized Financial Information)

2. SIGNIFICANT ACCOUNTING POLICIES, continued:

SUPPORT, REVENUE, AND EXPENSES, continued

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 \$6,470,000 and \$6,351,000 promoting its mission for the years ended December 31, 2017 and 2016, respectively.

ALLOCATION OF EXPENSES

The costs of providing program services and supporting activities have been summarized on a functional basis in the consolidated and combined statements 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,	
	2017	2016
Due in less than one year	\$ 37,225,377	\$ 11,847,000
Due in one to five years	7,848,656	14,691,000
	<u>45,074,033</u>	<u>26,538,000</u>
Less: present value discount	(263,226)	(229,505)
Less: allowance for uncollectible promises	<u>(2,251,302)</u>	<u>(1,315,425)</u>
	<u>\$ 42,559,505</u>	<u>\$ 24,993,070</u>

During the years ended December 31, 2017 and 2016, Mercy Ships received new pledges receivable of \$23,458,500 and \$3,075,000, respectively, approximately \$1,000,000 and \$0, respectively, of these pledges being from board members, and received payments of \$4,652,467 and \$6,147,421, respectively, toward these pledges. Mercy Ships accounts for the present value of pledges receivable using a risk-adjusted discount rate range of 0.5-1.5%. An allowance for uncollectible pledges receivable is recorded based upon collection history.

MERCY SHIPS AND AFFILIATES

Notes to Consolidated and Combined Financial Statements

December 31, 2017

December 31, 2016 (Summarized Financial Information)

4. INVENTORY:

Inventory consists of the following:

	December 31,	
	2017	2016
Medical supplies	\$ 2,530,947	\$ 2,525,921
Fuel	449,310	323,585
Food	176,418	192,281
Other	101,539	96,711
	\$ 3,258,214	\$ 3,138,498

5. PROPERTY AND EQUIPMENT—NET:

Property and equipment consists of:

	December 31,	
	2017	2016
Land and buildings	\$ 10,172,007	\$ 9,626,173
Ship and related improvements	67,202,747	67,144,980
Tools and equipment	2,814,834	3,437,853
Vehicles	1,552,761	1,448,246
Medical equipment	4,131,544	2,702,123
	85,873,893	84,359,375
Less accumulated depreciation	(45,396,227)	(42,531,389)
	40,477,666	41,827,986
Assets not placed into service	49,331,495	42,919,681
Property and equipment—net	\$ 89,809,161	\$ 84,747,667
Equity in property and equipment consists of the following:		
Property and equipment—net	\$ 89,809,161	\$ 84,747,667
Less: notes payable secured by property	(542,012)	(1,832,373)
Less: capital lease obligation	(1,622,728)	(1,510,548)
Total equity in property and equipment	\$ 87,644,421	\$ 81,404,746

MERCY SHIPS AND AFFILIATES

Notes to Consolidated and Combined Financial Statements

December 31, 2017

December 31, 2016 (Summarized Financial Information)

6. NOTES PAYABLE:

Notes payable consists of:

	December 31,	
	2017	2016
Note payable in the amount of approximately \$3,700,000, due in quarterly principal payments of approximately \$130,000 plus interest calculated at Eurobor plus 1.5%. Note was fully paid off in 2017.	\$ -	\$ 658,475
Note payable in the amount of approximately \$3,700,000, due in quarterly principal payments of approximately \$130,000 plus interest calculated at Eurobor plus 1.5%. Note was fully paid off in 2017.	-	658,475
Note payable in the amount of approximately \$600,000, due in annual principal payments of approximately \$40,000, plus interest of 3%. Note matures December 2030.	525,722	497,512
Various other secured and unsecured notes	16,290	17,911
	\$ 542,012	\$ 1,832,373

Based on currency exchange rates as of December 31, 2017, the aggregate maturities of notes payable for each of the subsequent years are:

<u>Year Ending December 31,</u>	<u>Amounts</u>
2018	\$ 36,677
2019	36,677
2020	36,677
2021	36,677
2022	36,677
Thereafter	358,627
	\$ 542,012

Mercy Ships was in compliance with, or had received waivers for, all financial and reporting covenants at December 31, 2017 and 2016.

MERCY SHIPS AND AFFILIATES

Notes to Consolidated and Combined Financial Statements

December 31, 2017

December 31, 2016 (Summarized Financial Information)

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 consolidated and combined statements 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, 2017 and 2016, the total lease obligation included accrued interest of \$883,747 and \$802,282, respectively.

For both the years ended December 31, 2017 and 2016, land and buildings of \$768,173 and \$735,915, respectively, have been capitalized under the lease agreement, and accumulated depreciation for the years ended December 31, 2017 and 2016, was \$230,452 and \$211,576, respectively.

Based on currency exchange rates as of December 31, 2017, the future minimum lease payments required for capital leases are:

<u>Year Ending December 31,</u>	<u>Amounts</u>
2018	\$ 64,920
2019	73,337
2020	73,337
2021	73,337
2022	80,728
Thereafter	<u>373,322</u>
	738,981
Accrued interest	<u>883,747</u>
	<u>\$ 1,622,728</u>

MERCY SHIPS AND AFFILIATES

Notes to Consolidated and Combined Financial Statements

December 31, 2017

December 31, 2016 (Summarized Financial Information)

8. UNRESTRICTED NET ASSETS:

Unrestricted net assets consist of:

	December 31,	
	2017	2016
Available for operations	\$ 20,637,435	\$ 15,052,606
Equity in property and equipment–net	87,644,421	81,404,746
Equity in inventory–net	3,258,214	3,138,498
Quasi endowments	14,782	14,393
	<u>\$ 111,554,852</u>	<u>\$ 99,610,243</u>

9. TEMPORARILY RESTRICTED NET ASSETS:

Temporarily restricted net assets consist of:

	December 31,	
	2017	2016
Capital project–new ship:		
Funds received, not spent	\$ 29,587,481	\$ 31,127,432
Pledges made, not received	42,559,505	24,993,070
	<u>72,146,986</u>	<u>56,120,502</u>
M/V Africa Mercy	10,496,022	9,750,822
Maxillofacial/plastic surgery projects	3,000,769	2,247,513
Mercy vision projects	1,631,147	1,587,216
Orthopedic projects	867,396	544,800
Women’s health projects	731,196	802,382
Non-surgical projects	666,475	884,741
General surgery projects	476,651	538,445
Dental projects	336,095	427,622
Crew assistance fund	133,364	313,638
Other ministry projects (including unappropriated endowment income)	544,075	349,060
	<u>\$ 91,030,176</u>	<u>\$ 73,566,741</u>

MERCY SHIPS AND AFFILIATES

Notes to Consolidated and Combined Financial Statements

December 31, 2017

December 31, 2016 (Summarized Financial Information)

10. ENDOWMENT FUNDS AND RELATED ASSETS:

Assets held for endowment funds consist of:

	December 31,	
	2017	2016
Cash and cash equivalents	\$ 1,049,888	\$ 835,019

Permanently restricted net assets consist of:

	December 31,	
	2017	2016
Crew assistance fund	\$ 107,000	\$ 107,000
Operations	80,000	80,000
Technical training	800,000	600,000
	\$ 987,000	\$ 787,000

The endowment net asset composition by type of fund as of December 31, 2017:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor restricted endowment funds	\$ -	\$ 48,106	\$ 987,000	\$ 1,035,106
Board-designated endowment funds	14,782	-	-	14,782
	\$ 14,782	\$ 48,106	\$ 987,000	\$ 1,049,888

Changes in endowment net assets for the year ended December 31, 2017:

Endowment net assets, beginning of year	\$ 14,393	\$ 33,626	\$ 787,000	\$ 835,019
Investment income	389	14,480	-	14,869
Contributions	-	-	200,000	200,000
Endowment net assets, end of year	\$ 14,782	\$ 48,106	\$ 987,000	\$ 1,049,888

MERCY SHIPS AND AFFILIATES

Notes to Consolidated and Combined Financial Statements

December 31, 2017

December 31, 2016 (Summarized Financial Information)

10. ENDOWMENT FUNDS AND RELATED ASSETS, continued:

The endowment net asset composition by type of fund as of December 31, 2016:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor restricted endowment funds	\$ -	\$ 33,626	\$ 787,000	\$ 820,626
Board-designated endowment funds	14,393	-	-	14,393
	\$ 14,393	\$ 33,626	\$ 787,000	\$ 835,019

Changes in endowment net assets for the year ended December 31, 2016:

Endowment net assets, beginning of year	\$ 14,124	\$ 24,485	\$ 582,000	\$ 620,609
Investment income	269	9,141	-	9,410
Contributions	-	-	205,000	205,000
Endowment net assets, end of year	\$ 14,393	\$ 33,626	\$ 787,000	\$ 835,019

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 TUPMIFA 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, 2017 and 2016, there are no deficiencies resulting from unfavorable market fluctuations, respectively.

11. 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 years ended December 31, 2017 and 2016.

MERCY SHIPS AND AFFILIATES

Notes to Consolidated and Combined Financial Statements

December 31, 2017

December 31, 2016 (Summarized Financial Information)

12. 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 consolidated and combined financial statements and are therefore eliminated upon combination.

The amount of funds transferred from the affiliates was as follows:

	December 31,	
	2017	2016
Australia	\$ 1,397,084	\$ 1,468,422
Belgium	1,912,972	1,064,202
Canada	882,105	345,681
Germany	1,650,962	1,603,050
Holland	3,316,557	3,396,763
Norway	1,838,302	1,941,415
Switzerland	2,924,820	5,065,842
United Kingdom	3,080,117	3,422,101
	<u>\$ 17,002,919</u>	<u>\$ 18,307,476</u>

MERCY SHIPS AND AFFILIATES

Notes to Consolidated and Combined Financial Statements

December 31, 2017

December 31, 2016 (Summarized Financial Information)

13. 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, 2017 and 2016, net assets of non-U.S. operations were 7.4% and 8.2% of Mercy Ships' total net assets, respectively.

Most of Mercy Ships' international affiliates use the local currency as the functional currency. The consolidated and combined financial statements of Mercy Ships' international affiliates have been translated into U.S. dollars. The consolidated and combined statements of financial position accounts have been translated using the exchange rate in effect at the consolidated and combined statements of financial position date. Consolidated and combined statements of activities amounts have been translated using the average exchange rate for the year. These adjustments for the years ended December 31, 2017 and 2016, are reflected accordingly on the consolidated and combined statements 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' consolidated and combined financial statements.

14. SUBSEQUENT EVENTS:

Subsequent events have been evaluated through May 11, 2018, which represents the date the consolidated and combined financial statements were available to be issued. Subsequent events after that date have not been evaluated.

SUPPLEMENTAL INFORMATION

**INDEPENDENT AUDITORS' REPORT
ON SUPPLEMENTAL INFORMATION**

Board of Directors
Mercy Ships and Affiliates
Lindale, Texas

We have audited the consolidated and combined financial statements of Mercy Ships and Affiliates as of and for the year ended December 31, 2017, and our report thereon dated May 11, 2018, which expresses an unmodified opinion on those consolidated and combined financial statements, appears on page 2. The prior year summarized comparative information has been derived from the Organization's December 31, 2016 consolidated and combined financial statements and, in our report dated May 1, 2017, we expressed an unmodified opinion on those consolidated and combined financial statements. Our audits were conducted for the purpose of forming an opinion on the consolidated and combined financial statements as a whole. The consolidated and combined schedules of functional expenses are presented for purposes of additional analysis and are not a required part of the consolidated and combined financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated and combined financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated and combined financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated and combined financial statements or to the consolidated and combined financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated and combined financial statements as a whole.

Capin Crouse LLP

Grapevine, Texas
May 11, 2018

MERCY SHIPS AND AFFILIATES

Consolidated and Combined Schedule of Functional Expenses

For the Year Ended December 31, 2017

	Program		Supporting Activities		Total Expenses
	Ship and Field Operations	General and Administrative	Fundraising	Fundraising	
Advertising and marketing	\$ 1,696,500	\$ 574,932	4,198,694	\$ 6,470,126	
Auto expense	144,747	19,673	33,207	197,627	
Conference, seminar, and trade shows	61,337	8,595	17,760	87,692	
Contract labor	6,029,079	1,016,825	2,017,688	9,063,592	
Distributed inventory	5,815,458	76,849	36,072	5,928,379	
Contributed salary expense	17,489,014	40,250	5,946	17,535,210	
Cost of goods sold	160,081	42,343	3,339	205,763	
Depreciation	3,733,818	80,410	29,707	3,843,935	
Food purchases	1,014,858	52,079	129	1,067,066	
Freight and customs	335,115	6,251	18,976	360,342	
Fuel and lube oil	1,093,057	-	-	1,093,057	
Gift expense—other charities	119,433	467	879	120,779	
Insurance	440,037	74,372	8,007	522,416	
Interest	106,018	18,845	14,273	139,136	
Legal and professional fees	161,042	37,696	30,413	229,151	
Meals and entertainment	267,021	14,224	43,977	325,222	
Medical and pharmaceutical supplies	836,082	-	-	836,082	
Miscellaneous	137,418	126,705	23,062	287,185	
Postage and printing	1,148,247	623,315	3,378,171	5,149,733	
Rents	427,203	149,233	474,769	1,051,205	
Repairs and maintenance	903,867	329,637	42,768	1,276,272	
Service charges	405,998	110,958	18,302	535,258	
Dry docking expense	1,855,817	-	-	1,855,817	
Small equipment and furniture	1,537,709	90,137	34,149	1,661,995	
Staff support and expenses	13,485,481	2,891,754	3,052,130	19,429,365	
Supplies	892,183	63,399	47,221	1,002,803	
Taxes and fees	57,262	19,029	9,064	85,355	
Telecommunications	541,166	19,737	12,170	573,073	
Travel	1,250,202	118,844	271,549	1,640,595	
Utilities	82,002	154,254	8,619	244,875	
	<u>\$ 62,227,252</u>	<u>\$ 6,760,813</u>	<u>\$ 13,831,041</u>	<u>\$ 82,819,106</u>	

MERCY SHIPS AND AFFILIATES

Consolidated and Combined Schedule of Functional Expenses

For the Year Ended December 31, 2016

	Program		Supporting Activities		Total Expenses
	Ship and Field Operations	General and Administrative	Fundraising	Fundraising	
Advertising and marketing	\$ 1,574,424	\$ 641,842	\$ 4,134,663	\$ 6,350,929	
Auto expense	150,652	17,056	17,043	184,751	
Conference, seminar, and trade shows	49,682	6,554	16,093	72,329	
Contract labor	3,797,266	484,371	1,387,366	5,669,003	
Distributed inventory	3,676,112	3,577	5,704	3,685,393	
Contributed salary expense	16,872,501	47,615	24,545	16,944,661	
Cost of goods sold	180,752	86,605	8,935	276,292	
Depreciation	3,512,228	77,161	24,522	3,613,911	
Food purchases	874,249	45,469	294	920,012	
Freight and customs	192,908	4,325	14,764	211,997	
Fuel and lube oil	1,193,601	-	-	1,193,601	
Gift expense—other charities	76,525	688	1,278	78,491	
Insurance	398,684	69,881	7,948	476,513	
Interest	117,759	18,281	14,789	150,829	
Legal and professional fees	162,736	37,201	29,930	229,867	
Meals and entertainment	62,276	3,899	13,448	79,623	
Medical and pharmaceutical supplies	570,524	570	-	571,094	
Miscellaneous	231,698	41,085	58,964	331,747	
Postage and printing	920,081	496,283	2,708,448	4,124,812	
Rents	417,002	104,589	307,377	828,968	
Repairs and maintenance	794,862	131,744	16,800	943,406	
Service charges	319,648	81,487	18,021	419,156	
Dry docking expense	843,271	-	-	843,271	
Small equipment and furniture	736,637	58,114	28,811	823,562	
Staff support and expenses	11,927,878	2,511,400	2,581,607	17,020,885	
Supplies	762,239	67,414	42,412	872,065	
Taxes and fees	20,018	9,706	3,072	32,796	
Telecommunications	435,616	19,995	12,864	468,475	
Travel	868,681	85,947	154,578	1,109,206	
Utilities	64,367	145,798	7,379	217,544	
Total Expenses	\$ 51,804,877	\$ 5,298,657	\$ 11,641,655	\$ 68,745,189	