



## MERCY SHIPS AND AFFILIATES

Consolidated and Combined  
Financial Statements  
With Independent Auditors' Report

December 31, 2016

# MERCY SHIPS AND AFFILIATES

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## INDEPENDENT AUDITORS' REPORT

Board of Directors  
Mercy Ships and Affiliates  
Lindale, Texas

### **Report on the 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, 2016, 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, 2016, 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' 2015 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 2, 2016. In our opinion, the summarized comparative information presented herein as of and for the year ended December 31, 2015, 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 1, 2017

# MERCY SHIPS AND AFFILIATES

## Consolidated and Combined Statements of Financial Position

December 31, 2016

With Comparative Totals for December 31, 2015

	2016	2015
<b>ASSETS:</b>		
Cash and cash equivalents	\$ 55,276,785	\$ 41,954,996
Cash held for others—ship bank	878,072	945,465
Certificate of deposit	12,180,443	12,063,441
Accounts receivable—net	929,945	829,795
Pledges receivable—net	24,993,070	27,886,663
Inventory	3,138,498	3,307,691
Other assets and surrender value of life insurance	189,596	183,602
Prepaid expenses and advances	546,835	199,024
Property and equipment—net	84,747,667	73,118,986
<b>Total Assets</b>	<b>\$ 182,880,911</b>	<b>\$ 160,489,663</b>
<b>LIABILITIES AND NET ASSETS:</b>		
<b>Liabilities:</b>		
Accounts payable and accrued expenses	\$ 4,530,423	\$ 7,490,051
Ship bank payable	984,454	1,067,120
Deferred revenue	59,129	85,406
Notes payable	1,832,373	3,026,122
Capital lease obligation	1,510,548	1,507,024
<b>Total liabilities</b>	<b>8,916,927</b>	<b>13,175,723</b>
<b>Net assets:</b>		
Unrestricted	99,610,243	82,890,546
Temporarily restricted	73,566,741	63,841,394
Permanently restricted	787,000	582,000
<b>Total net assets</b>	<b>173,963,984</b>	<b>147,313,940</b>
<b>Total Liabilities and Net Assets</b>	<b>\$ 182,880,911</b>	<b>\$ 160,489,663</b>

See notes to consolidated and combined financial statements

# MERCY SHIPS AND AFFILIATES

## Consolidated and Combined Statements of Activities

For the Year Ended December 31, 2016  
With Comparative Totals for the Year Ended December 31, 2015

	Unrestricted	Temporarily Restricted	Permanently Restricted	2016 Total	2015 Total
<b>SUPPORT AND REVENUE:</b>					
Contributions	\$ 40,954,669	\$ 24,692,413	\$ 205,000	\$ 65,852,082	\$ 64,072,806
Contributions for staff support	4,446,365	-	-	4,446,365	4,905,489
Gift-in-kind contributions	3,858,697	-	-	3,858,697	2,575,111
Contributed services	16,944,661	-	-	16,944,661	17,542,814
Fee revenue	1,739,159	-	-	1,739,159	1,864,192
Sales and other revenue	2,104,540	9,141	-	2,113,681	2,008,637
Gain (loss) from translation adjustments	(1,156,509)	-	-	(1,156,509)	82,493
Gain (loss) on sale of property and equipment	68,625	-	-	68,625	(6,879)
<b>Total Support and Revenue</b>	<b>68,960,207</b>	<b>24,701,554</b>	<b>205,000</b>	<b>93,866,761</b>	<b>93,044,663</b>
<b>NET ASSETS RELEASED:</b>					
Purpose restrictions	14,976,207	(14,976,207)	-	-	-
<b>EXPENSES:</b>					
Program services:					
Ship and field operations	51,804,877	-	-	51,804,877	50,287,474
Supporting activities:					
General and administrative	5,298,657	-	-	5,298,657	5,151,427
Fundraising	11,641,655	-	-	11,641,655	11,519,070
<b>Total supporting activities</b>	<b>16,940,312</b>	<b>-</b>	<b>-</b>	<b>16,940,312</b>	<b>16,670,497</b>
<b>Total Expenses</b>	<b>68,745,189</b>	<b>-</b>	<b>-</b>	<b>68,745,189</b>	<b>66,957,971</b>
<b>Change in Net Assets Before Change in Cumulative Translation Adjustments</b>	<b>15,191,225</b>	<b>9,725,347</b>	<b>205,000</b>	<b>25,121,572</b>	<b>26,086,692</b>
<b>Cumulative Translation Adjustments</b>	<b>1,528,472</b>	<b>-</b>	<b>-</b>	<b>1,528,472</b>	<b>(1,870,426)</b>
<b>Change in Net Assets</b>	<b>16,719,697</b>	<b>9,725,347</b>	<b>205,000</b>	<b>26,650,044</b>	<b>24,216,266</b>
<b>Net Assets, Beginning of Year</b>	<b>82,890,546</b>	<b>63,841,394</b>	<b>582,000</b>	<b>147,313,940</b>	<b>123,097,674</b>
<b>Net Assets, End of Year</b>	<b>\$ 99,610,243</b>	<b>\$ 73,566,741</b>	<b>\$ 787,000</b>	<b>\$ 173,963,984</b>	<b>\$ 147,313,940</b>

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, 2016  
With Comparative Totals for the Year Ended December 31, 2015

	2016	2015
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Change in net assets	\$ 26,650,044	\$ 24,216,266
Adjustments to reconcile change in net assets to net cash provided(used) by operating activities:		
Depreciation	3,613,911	3,546,603
(Gain) loss on sale of property and equipment	(62,624)	868
(Gain) loss from translation adjustments	93,965	(129,555)
Contributions restricted for long-term purposes	(22,369,539)	(15,235,558)
Changes in operating assets and liabilities:		
Accounts receivable–net	(100,150)	10,997
Pledges receivable–net	2,893,593	(9,547,036)
Inventory	169,193	511,076
Other assets and surrender value of life insurance	(5,994)	(19,174)
Prepaid expenses and advances	(347,811)	25,947
Accounts payable and accrued expenses	(3,142,203)	2,894,076
Ship bank payable	(82,666)	217,240
Deferred revenue	(26,277)	(622,508)
Net Cash Provided by Operating Activities	7,283,442	5,869,242
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Proceeds from sale of property and equipment	67,961	4,829
Purchases of certificates of deposit	(117,002)	(12,063,441)
Purchases of property and equipment	(15,168,275)	(14,487,766)
Net Cash Used by Investing Activities	(15,217,316)	(26,546,378)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Contributions restricted for long-term purposes	22,369,539	15,235,558
Proceeds from notes payable	-	567,548
Payments on notes payable	(1,138,435)	(1,303,024)
Payments on capital lease obligations	(42,834)	(63,847)
Net Cash Provided by Financing Activities	21,188,270	14,436,235
Change in Cash and Cash Equivalents	13,254,396	(6,240,901)
Cash and Cash Equivalents and Ship Bank, Beginning of Year	42,900,461	49,141,362
Cash and Cash Equivalents and Ship Bank, End of Year	\$ 56,154,857	\$ 42,900,461
<b>SUPPLEMENTAL DISCLOSURE:</b>		
Cash paid for interest (none capitalized)	\$ 150,829	\$ 159,872
Property and equipment capitalized, not yet paid for	\$ 182,575	\$ 476,512

See notes to consolidated and combined financial statements

# MERCY SHIPS AND AFFILIATES

## Notes to Consolidated and Combined Financial Statements

December 31, 2016

December 31, 2015 (Summarized Comparative)

### 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 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 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, combined financial statements are presented for these affiliates.



# MERCY SHIPS AND AFFILIATES

## Notes to Consolidated and Combined Financial Statements

December 31, 2016

December 31, 2015 (Summarized Comparative)

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 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 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 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 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.

# MERCY SHIPS AND AFFILIATES

## Notes to Consolidated and Combined Financial Statements

December 31, 2016

December 31, 2015 (Summarized Comparative)

### 2. SIGNIFICANT ACCOUNTING POLICIES, continued:

#### 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, 2016 and 2015, the allowance for doubtful accounts was \$9,055 and \$7,259, 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 \$229,505 and \$256,039, respectively, and an allowance for uncollectible receivables of \$1,315,425 and \$1,467,719, respectively, as of December 31, 2016 and 2015. Subsequent to December 31, 2016, collections on pledges receivables totaled \$1,106,500.

#### 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, 2016 and 2015, 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, 2016

December 31, 2015 (Summarized Comparative)

### 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, 2016

December 31, 2015 (Summarized Comparative)

### 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 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.

Of the \$3,858,697 and \$2,575,111 gift-in-kind contributions reflected in the consolidated and combined statements of activities for the years ended December 31, 2016 and 2015, respectively, 100% and 99% was used by Mercy Ships in its own programs and 0% and 1% 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,	
	2016	2015
Program services - professional and medical	\$ 16,872,501	\$ 17,219,355
General and administrative support staff	47,615	230,925
Fundraising	24,545	92,534
	<u>\$ 16,944,661</u>	<u>\$ 17,542,814</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 consolidated and combined statements of activities.

# MERCY SHIPS AND AFFILIATES

## Notes to Consolidated and Combined Financial Statements

December 31, 2016

December 31, 2015 (Summarized Comparative)

### 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 \$6,351,000 and \$4,775,000 promoting its mission for the years ended December 31, 2016 and 2015, respectively.

#### UNCERTAIN TAX POSITIONS

The financial statement effects of a tax position taken or expected to be taken are recognized in the consolidated and combined 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 consolidated and combined statements of activities. As of December 31, 2016, Mercy Ships had no uncertain tax positions that qualify for recognition or disclosure in the consolidated and combined 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, 2016, Mercy Ships' tax returns for the years 2013 through 2015 remain subject to examination.

#### 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.

# MERCY SHIPS AND AFFILIATES

## Notes to Consolidated and Combined Financial Statements

December 31, 2016

December 31, 2015 (Summarized Comparative)

3. PLEDGES RECEIVABLE—NET:

Pledges receivable—net, consist of:

	December 31,	
	2016	2015
Due in less than one year	\$ 11,847,000	\$ 13,164,921
Due in one to five years	14,691,000	16,445,500
	26,538,000	29,610,421
Less: present value discount	(229,505)	(256,039)
Less: allowance for uncollectible promises	(1,315,425)	(1,467,719)
	\$ 24,993,070	\$ 27,886,663

During the years ended December 31, 2016 and 2015, Mercy Ships received new pledges receivable of \$3,075,000 and \$21,270,000, respectively, approximately \$0 and \$20,000,000, respectively, of these pledges being from board members, and received payments of \$6,147,421 and \$11,027,054, respectively, toward these pledges.

4. INVENTORY:

Inventory consists of the following:

	December 31,	
	2016	2015
Medical supplies	\$ 2,525,921	\$ 2,751,913
Fuel	323,585	331,994
Food	192,281	176,905
Other	96,711	46,879
	\$ 3,138,498	\$ 3,307,691

# MERCY SHIPS AND AFFILIATES

## Notes to Consolidated and Combined Financial Statements

December 31, 2016

December 31, 2015 (Summarized Comparative)

5. PROPERTY AND EQUIPMENT–NET:

Property and equipment consists of:

	December 31,	
	2016	2015
Land and buildings	\$ 9,626,173	\$ 9,470,190
Ship and related improvements	67,144,980	67,110,403
Tools and equipment	3,437,853	3,434,431
Vehicles	1,448,246	1,435,768
Medical equipment	2,702,123	2,345,228
	84,359,375	83,796,020
Less accumulated depreciation	(42,531,389)	(39,162,924)
	41,827,986	44,633,096
Assets not placed into service	42,919,681	28,485,890
	\$ 84,747,667	\$ 73,118,986
Equity in property and equipment consists of the following:		
Property and equipment–net	\$ 84,747,667	\$ 73,118,986
Less: notes payable secured by property	(1,832,373)	(3,026,122)
Less: capital lease obligation	(1,510,548)	(1,507,024)
	\$ 81,404,746	\$ 68,585,840

# MERCY SHIPS AND AFFILIATES

## Notes to Consolidated and Combined Financial Statements

December 31, 2016

December 31, 2015 (Summarized Comparative)

### 6. NOTES PAYABLE:

Notes payable consists of:

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
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.	\$ 658,475	\$ 1,229,287
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.	658,475	1,229,287
Note payable in the amount of €500,000, due in annual principal payments of €33,333, plus interest of 3%. Note matures December 2030.	497,512	545,300
Various other secured and unsecured notes	<u>17,911</u>	<u>22,248</u>
	<u>\$ 1,832,373</u>	<u>\$ 3,026,122</u>

Based on currency exchange rates as of December 31, 2016, the aggregate maturities of notes payable for each of the subsequent years are:

#### Year Ending December 31,

2017	\$ 1,088,519
2018	298,349
2019	34,959
2020	34,959
2021	34,959
Thereafter	<u>340,628</u>
	<u>\$ 1,832,373</u>

Mercy Ships was in compliance with, or had received waivers for, all financial and reporting covenants at December 31, 2016 and 2015.



# MERCY SHIPS AND AFFILIATES

## Notes to Consolidated and Combined Financial Statements

December 31, 2016

December 31, 2015 (Summarized Comparative)

### 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, 2016 and 2015, the total lease obligation included accrued interest of \$802,282 and \$781,126, respectively.

For both the years ended December 31, 2016 and 2015, land and buildings of CHF 750,000 (\$735,915 and \$755,475, respectively, as of December 31, 2016 and 2015) has been capitalized under the lease agreement and accumulated depreciation for the years ended December 31, 2016 and 2015, was CHF 215,625 and CHF 206,250, respectively, (\$211,576 and \$207,756, respectively).

Based on currency exchange rates as of December 31, 2016, the future minimum lease payments required for capital leases are:

<u>Year Ending December 31,</u>	
2017	\$ 63,521
2018	69,942
2019	69,942
2020	69,942
2021	77,022
Thereafter	357,897
	<hr/>
	708,266
Accrued interest	802,282
	<hr/>
	<u>\$ 1,510,548</u>

# MERCY SHIPS AND AFFILIATES

## Notes to Consolidated and Combined Financial Statements

December 31, 2016

December 31, 2015 (Summarized Comparative)

### 8. UNRESTRICTED NET ASSETS:

Unrestricted net assets consist of:

	December 31,	
	2016	2015
Available for operations	\$ 15,052,606	\$ 10,982,891
Equity in property and equipment–net	81,404,746	68,585,840
Equity in inventory–net	3,138,498	3,307,691
Quasi endowments	14,393	14,124
	<u>\$ 99,610,243</u>	<u>\$ 82,890,546</u>

### 9. TEMPORARILY RESTRICTED NET ASSETS:

Temporarily restricted net assets consist of:

	December 31,	
	2016	2015
Capital project–new ship:		
Funds received, not spent	\$ 31,127,432	\$ 24,807,491
Pledges made, not received	24,993,070	27,886,663
	<u>56,120,502</u>	<u>52,694,154</u>
M/V Africa Mercy	9,750,822	4,900,563
Maxillofacial/plastic surgery projects	2,247,513	1,724,916
Mercy vision projects	1,587,216	1,009,864
Women’s health projects	802,382	852,686
Non-surgical projects	884,741	535,556
Orthopedic projects	544,800	425,665
General surgery projects	538,445	419,290
Dental projects	427,622	410,815
Crew assistance fund	313,638	344,115
Other ministry projects (including unappropriated endowment income)	349,060	523,770
	<u>\$ 73,566,741</u>	<u>\$ 63,841,394</u>

# MERCY SHIPS AND AFFILIATES

## Notes to Consolidated and Combined Financial Statements

December 31, 2016

December 31, 2015 (Summarized Comparative)

### 10. ENDOWMENT FUNDS AND RELATED ASSETS:

Assets held for endowment funds consist of:

	December 31,	
	2016	2015
Cash and cash equivalents	\$ 835,019	\$ 620,609

Permanently restricted net assets consist of:

	December 31,	
	2016	2015
Crew assistance fund	\$ 107,000	\$ 102,000
Operations	80,000	80,000
Technical training	600,000	400,000
	<u>\$ 787,000</u>	<u>\$ 582,000</u>

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
	<u>\$ 14,393</u>	<u>\$ 33,626</u>	<u>\$ 787,000</u>	<u>\$ 835,019</u>

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	<u>\$ 14,393</u>	<u>\$ 33,626</u>	<u>\$ 787,000</u>	<u>\$ 835,019</u>

# MERCY SHIPS AND AFFILIATES

## Notes to Consolidated and Combined Financial Statements

December 31, 2016

December 31, 2015 (Summarized Comparative)

### 10. ENDOWMENT FUNDS AND RELATED ASSETS, continued:

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

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor restricted endowment funds	\$ -	\$ 24,485	\$ 582,000	\$ 606,485
Board-designated endowment funds	14,124	-	-	14,124
	\$ 14,124	\$ 24,485	\$ 582,000	\$ 620,609

Changes in endowment net assets for the year ended December 31, 2015:

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

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, 2016 and 2015, there are no deficiencies resulting from unfavorable market fluctuations, respectively.

### 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 both December 31, 2016 and 2015, and the estimated fair value does not materially differ from the aggregate carrying values of its financial instruments reflected in the accompanying consolidated and combined statements 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 years ended December 31, 2016 and 2015.

# MERCY SHIPS AND AFFILIATES

## Notes to Consolidated and Combined Financial Statements

December 31, 2016

December 31, 2015 (Summarized Comparative)

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

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

	December 31,	
	2016	2015
Australia	\$ 1,468,422	\$ 1,528,140
Belgium	1,064,202	1,432,883
Canada	345,681	250,083
Germany	1,603,050	1,209,113
Holland	3,396,763	2,096,844
Norway	1,941,415	587,358
Switzerland	5,065,842	7,364,761
United Kingdom	3,422,101	3,901,321
	<u>\$ 18,307,476</u>	<u>\$ 18,370,503</u>

# MERCY SHIPS AND AFFILIATES

## Notes to Consolidated and Combined Financial Statements

December 31, 2016

December 31, 2015 (Summarized Comparative)

### 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, 2016 and 2015, net assets of non-U.S. operations were 8.2% and 6.7% 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, 2016 and 2015, 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.

### 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.

## **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, 2016, and our report thereon dated May 1, 2017, 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, 2015, consolidated and combined financial statements and, in our report dated May 2, 2016, we expressed an unmodified opinion on those consolidated and combined financial statements. Our audit 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 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 1, 2017



# 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	Total Expenses	
Advertising and marketing	\$ 1,574,424	\$ 641,842	\$ 4,134,663	\$ 6,350,929	
Audit and accounting	102,236	24,218	15,332	141,786	
Auto expense	150,652	17,056	17,043	184,751	
Bad debt	10,663	(670)	-	9,993	
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	
Contributed goods	3,676,112	3,577	5,704	3,685,393	
Contributed services	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 fees	60,500	12,983	14,598	88,081	
Meals and entertainment	62,276	3,899	13,448	79,623	
Medical and pharmaceutical supplies	570,524	570	-	571,094	
Miscellaneous	221,035	41,755	58,964	321,754	
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	
Shipyards	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	
<b>Total Expenses</b>	<b>\$ 51,804,877</b>	<b>\$ 5,298,657</b>	<b>\$ 11,641,655</b>	<b>\$ 68,745,189</b>	

# MERCY SHIPS AND AFFILIATES

## Consolidated and Combined Schedule of Functional Expenses

For the Year Ended December 31, 2015

	Program		Supporting Activities		Total Expenses
	Ship and Field Operations	General and Administrative	Fundraising	Fundraising	
Advertising and marketing	\$ 549,526	\$ 392,588	\$ 3,832,891	\$ 4,775,005	
Audit and accounting	29,415	93,122	-	122,537	
Auto expense	163,953	19,552	21,198	204,703	
Bad debt	4,422	2,122	-	6,544	
Conference, seminar and trade shows	53,285	5,658	21,158	80,101	
Contract labor	3,231,011	422,111	1,196,279	4,849,401	
Contributed goods	2,538,643	38,454	225	2,577,322	
Contributed services	17,219,355	230,925	92,534	17,542,814	
Cost of goods sold	167,971	51,424	8,646	228,041	
Depreciation	3,450,866	77,666	16,431	3,544,963	
Food purchases	929,957	33,171	78	963,206	
Freight and customs	213,529	2,152	8,827	224,508	
Fuel and lube oil	1,440,853	-	-	1,440,853	
Gift expense - other charities	79,881	2,830	7,179	89,890	
Insurance	447,688	84,356	9,277	541,321	
Interest	142,884	8,511	8,477	159,872	
Legal fees	100,393	6,755	32,670	139,818	
Meals and entertainment	63,050	5,447	13,770	82,267	
Medical and pharmaceutical supplies	572,606	-	-	572,606	
Miscellaneous	422,006	74,343	126,912	623,261	
Postage and printing	525,958	490,828	2,816,636	3,833,422	
Rents	267,759	105,303	333,517	706,579	
Repairs and maintenance	614,549	191,819	8,713	815,081	
Service charges	300,624	77,465	18,686	396,775	
Shipyards	1,654,343	-	-	1,654,343	
Small equipment and furniture	996,093	62,801	12,914	1,071,808	
Staff support and expenses	11,542,323	2,300,971	2,668,820	16,512,114	
Supplies	910,814	98,001	55,830	1,064,645	
Taxes and fees	28,056	8,417	3,637	40,110	
Telecommunications	395,118	19,476	12,109	426,703	
Travel	1,172,525	83,197	184,168	1,439,890	
Utilities	58,018	161,962	7,488	227,468	
	<u>\$ 50,287,474</u>	<u>\$ 5,151,427</u>	<u>\$ 11,519,070</u>	<u>\$ 66,957,971</u>	