



MERCY SHIPS AND AFFILIATES

Consolidated and Combined  
Financial Statements  
With Independent Auditors' Report

December 31, 2018 and 2017

# 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, 2018, and the related consolidated and combined statements of activities, functional expenses, 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, 2018, 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' 2017 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 11, 2018. In our opinion, the summarized comparative information presented herein as of and for the year ended December 31, 2018, is consistent, in all material respects, with the audited consolidated and combined financial statements from which it has been derived.

***Emphasis of Matter***

The Organization has adopted Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) No. 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*, as described in Note 2. This has had a material effect on the presentation of the December 31, 2018 and 2017, consolidated and combined financial statements. Our opinion is not modified with respect to this matter.

*Capin Crouse LLP*

Grapevine, Texas  
May 16, 2019

# MERCY SHIPS AND AFFILIATES

## Consolidated and Combined Statements of Financial Position

December 31, 2018

With Summarized Financial Information for December 31, 2017

	2018	2017
<b>ASSETS:</b>		
Cash and cash equivalents	\$ 46,256,973	\$ 30,588,569
Cash held for others—ship bank	1,074,996	1,428,030
Certificate of deposit	5,014,378	12,308,955
Pledges receivable—net	31,323,702	42,559,505
Other receivables	1,657,544	1,257,540
Inventory	4,833,796	3,258,214
Prepaid expenses and other assets	3,957,831	1,455,105
Cash and cash equivalents held for long-term purposes	52,436,452	30,637,369
Property and equipment—net	103,288,589	89,809,161
<b>Total Assets</b>	<b>\$ 249,844,261</b>	<b>\$ 213,302,448</b>
<b>LIABILITIES AND NET ASSETS:</b>		
Liabilities:		
Accounts payable and accrued expenses	\$ 8,792,847	\$ 6,391,666
Ship bank payable	1,190,774	1,080,656
Other liabilities	1,932,377	2,258,098
	11,915,998	9,730,420
Net Assets:		
Net assets without donor restrictions	133,450,470	111,554,852
Net assets with donor restrictions:		
Restricted by purpose or time	103,290,793	91,030,176
Restricted in perpetuity	1,187,000	987,000
	104,477,793	92,017,176
<b>Total Net Assets</b>	<b>237,928,263</b>	<b>203,572,028</b>
<b>Total Liabilities and Net Assets</b>	<b>\$ 249,844,261</b>	<b>\$ 213,302,448</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, 2018  
With Summarized Financial Information for the Year Ended December 31, 2017

	Net Assets Without Donor Restrictions	Net Assets With Donor Restrictions	2018 Total	2017 Total
<b>SUPPORT AND REVENUE:</b>				
Contributions	\$ 44,591,751	\$ 46,052,832	\$ 90,644,583	\$ 77,896,763
Contributions for staff support	4,746,005	-	4,746,005	4,183,293
Gift-in-kind contributions	3,306,036	-	3,306,036	7,717,140
Contributed services	18,773,619	-	18,773,619	17,535,208
Fee revenue	1,725,001	-	1,725,001	1,789,286
Sales and other revenue	5,727,535	(249)	5,727,286	1,727,438
Gain (loss) from translation adjustments	(1,337,992)	-	(1,337,992)	886,444
<b>Total Support and Revenue</b>	<b>77,531,955</b>	<b>46,052,583</b>	<b>123,584,538</b>	<b>111,735,572</b>
<b>NET ASSETS RELEASED:</b>				
Purpose restrictions	33,591,966	(33,591,966)	-	-
<b>EXPENSES:</b>				
Program services:				
Ship and field operations	66,264,371	-	66,264,371	62,227,252
Supporting activities:				
General and administrative	6,045,513	-	6,045,513	6,760,813
Fundraising	15,946,825	-	15,946,825	13,831,041
	21,992,338	-	21,992,338	20,591,854
<b>Total Expenses</b>	<b>88,256,709</b>	<b>-</b>	<b>88,256,709</b>	<b>82,819,106</b>
Change in Net Assets Before Change in Cumulative Translation Adjustments	22,867,212	12,460,617	35,327,829	28,916,466
Cumulative Translation Adjustments	(971,594)	-	(971,594)	691,578
Change in Net Assets	21,895,618	12,460,617	34,356,235	29,608,044
Net Assets, Beginning of Year	111,554,852	92,017,176	203,572,028	173,963,984
Net Assets, End of Year	<b>\$ 133,450,470</b>	<b>\$104,477,793</b>	<b>\$ 237,928,263</b>	<b>\$ 203,572,028</b>

See notes to consolidated and combined financial statements

# MERCY SHIPS AND AFFILIATES

## Consolidated and Combined Statement of Functional Expenses

For the Year Ended December 31, 2018

	Program		Supporting Activities		Total Expenses
	Ship and Field Operations	General and Administrative	Fundraising	Fundraising	
Advertising and marketing	\$ 2,808,994	\$ 673,598	\$ 5,632,516	\$ 9,115,108	
Auto expense	219,530	9,764	30,740	260,034	
Conference, seminar, and trade shows	64,819	6,991	21,438	93,248	
Contract labor	6,599,681	961,336	2,216,666	9,777,683	
Contributed salary expense	18,773,344	120	155	18,773,619	
Cost of goods sold	240,600	78,382	9,774	328,756	
Depreciation	3,767,597	73,677	34,231	3,875,505	
Distributed inventory	3,333,006	32,500	33,764	3,399,270	
Dry docking and related expenses	1,613,847	-	-	1,613,847	
Food purchases	952,555	21,957	799	975,311	
Freight and customs	336,921	5,851	17,207	359,979	
Fuel and lube oil	1,344,696	-	-	1,344,696	
Gift expense—other charities	57,324	1,866	3,127	62,317	
Insurance	464,316	43,207	6,387	513,910	
Interest	93,905	19,348	14,274	127,527	
Legal and professional fees	167,172	38,848	25,403	231,423	
Meals and entertainment	279,044	7,682	31,828	318,554	
Miscellaneous	460,179	76,510	107,209	643,898	
Postage and printing	1,067,590	447,620	3,790,413	5,305,623	
Rents	609,267	122,251	572,463	1,303,981	
Repairs and maintenance	1,246,881	109,027	10,947	1,366,855	
Service charges	553,831	148,407	26,253	728,491	
Small equipment and furniture	1,249,656	100,324	10,955	1,360,935	
Staff support and expenses	16,583,771	2,776,456	2,983,154	22,343,381	
Supplies	1,017,969	64,254	46,600	1,128,823	
Taxes and fees	27,889	5,037	1,115	34,041	
Telecommunications	621,736	18,023	12,627	652,386	
Travel	1,495,671	148,488	296,231	1,940,390	
Utilities	212,580	53,989	10,549	277,118	
<b>Total Expenses</b>	<b>\$ 66,264,371</b>	<b>\$ 6,045,513</b>	<b>\$ 15,946,825</b>	<b>\$ 88,256,709</b>	

See notes to consolidated and combined financial statements

# MERCY SHIPS AND AFFILIATES

## Consolidated and Combined Statement of Functional Expenses

For the Year Ended December 31, 2017

	Program		Supporting Activities		Total Expenses
	Ship and Field Operations		General and Administrative	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
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
Distributed inventory	5,815,458		76,849	36,072	5,928,379
Dry docking expense	1,855,817		-	-	1,855,817
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
Miscellaneous	973,500		126,705	23,062	1,123,267
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
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>

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, 2018

With Summarized Financial Information for the Year Ended December 31, 2017

	2018	2017
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Change in net assets	\$ 34,356,235	\$ 29,608,044
Adjustments to reconcile change in net assets to net cash provided (used) by operating activities:		
Depreciation	3,875,505	3,843,935
Loss on sale of property and equipment	147	2,474
(Gain) loss from translation adjustments	971,594	(691,578)
Contributions received for long-term purposes	(29,292,114)	(25,186,674)
Changes in operating assets and liabilities:		
Other receivables	(400,004)	(327,595)
Inventory	(1,575,582)	(119,716)
Prepaid expenses and other assets	(2,502,726)	(718,674)
Accounts payable and accrued expenses	1,980,321	1,861,243
Ship bank payable	110,118	96,202
Other liabilities	(325,721)	(1,391,134)
Net Cash Provided by Operating Activities	7,197,773	6,976,527
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
(Purchases) sales of certificates of deposit	7,294,577	(128,512)
Purchases of property and equipment	(16,725,105)	(8,583,540)
Net Cash Used by Investing Activities	(9,430,528)	(8,712,052)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from contributions for long-term purposes	40,528,945	7,471,316
Transfers of cash received for long-term purposes	(21,904,937)	(4,660,357)
Net Cash Provided by Financing Activities	18,624,008	2,810,959
Effect of Exchange Rate Changes on Cash	(1,075,883)	614,397
Change in Cash and Cash Equivalents	15,315,370	1,689,831
Cash and Cash Equivalents and Ship Bank, Beginning of Year	32,016,599	30,326,768
Cash and Cash Equivalents and Ship Bank, End of Year	47,331,969	32,016,599
Cash Held for Long-term Purposes	52,436,452	30,637,369
Total Cash and Cash Equivalents, End of Year	\$ 99,768,421	\$ 62,653,968

See notes to consolidated and combined financial statements

# MERCY SHIPS AND AFFILIATES

## Notes to Consolidated and Combined Financial Statements

December 31, 2018

December 31, 2017 (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 are 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, 2018

December 31, 2017 (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, 2018 and 2017, Mercy Ship's cash balances exceeded federally insured limits by approximately \$79,000,000 and \$59,200,000, 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, 2018

December 31, 2017 (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.

#### 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, 2018, collections on pledges receivables totaled \$5,177,500.

#### INVENTORY

Inventory consists primarily of medical supplies, food, fuel, and lubricating oil. If purchased, these items are stated at the lower of cost or net realizable value 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, 2018 and 2017, 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, 2018

December 31, 2017 (Summarized Financial Information)

### 2. SIGNIFICANT ACCOUNTING POLICIES, continued:

#### NET ASSETS

The following classes of net assets are maintained:

*Net assets without donor restrictions* 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.

*Net assets with donor restrictions* 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. These include donor restrictions requiring that net assets be held in perpetuity, with use of all or part of the income earned on related investments for specific purposes.

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 net assets with donor restrictions in perpetuity (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 net assets with donor restrictions in perpetuity is classified as net assets with donor restrictions 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, 2018

December 31, 2017 (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 net assets with donor restrictions are reclassified to net assets without donor restrictions 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 distributed inventory. The donated products are valued in a manner consistent with Association of Evangelical Relief and Development Organizations Interagency Gift-in-Kind Standards.

Of the \$3,306,036 and \$7,704,377 gift-in-kind contributions reflected in the consolidated and combined statements of activities for the years ended December 31, 2018 and 2017, respectively, 100% and 98% was used by Mercy Ships in its own programs and 0% and 2% 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,	
	2018	2017
Program services—professional and medical	\$ 18,773,344	\$ 17,489,014
General and administrative support staff	120	40,250
Fundraising	155	5,944
	<u>\$ 18,773,619</u>	<u>\$ 17,535,208</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, 2018

December 31, 2017 (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 \$9,115,000 and \$6,470,000 promoting its mission for the years ended December 31, 2018 and 2017, respectively.

#### ALLOCATION OF EXPENSES

Expenses are recorded when incurred in accordance with the accrual basis of accounting. The costs of providing various program services and supporting activities have been summarized on a functional basis in the consolidated and combined statements of activities. Accordingly, certain costs such as depreciation and salaries have been allocated among the program services and supporting activities benefited. The consolidated and combined statements of functional expenses report certain categories of expenses that are attributable to more than one program or supporting function. Therefore, these expenses require allocation on a reasonable basis that is consistently applied. The expenses that are allocated included depreciation expense and utilities that are based on square footage, as well as salaries and benefits which are allocated based on estimates of time and effort.

#### RECENTLY ISSUED ACCOUNTING STANDARDS

In 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*. Mercy Ships adopted the provisions of this new standard during the year ended December 31, 2018. In addition to changes in terminology used to describe categories of net assets throughout the financial statements, new disclosures were added regarding liquidity and the availability of resources (Note 3), consolidated and combined statements of expenses by functional and natural classification was added and disclosures related to functional allocation of expenses were expanded (Note 2).

# MERCY SHIPS AND AFFILIATES

## Notes to Consolidated and Combined Financial Statements

December 31, 2018

December 31, 2017 (Summarized Financial Information)

### 3. LIQUIDITY AND FUNDS AVAILABLE:

The following table reflects Mercy Ship's financial assets as of December 31, 2018, reduced by amounts not available for general expenditure within one year. Financial assets are considered unavailable when illiquid or not convertible to cash within one year, or because the governing board has set aside the funds for specific contingency reserves and projects or a long-term investment as board designated endowments.

Financial assets:	
Cash and cash equivalents	\$ 46,256,973
Cash held for others—ship bank	1,074,996
Certificate of deposit	5,014,378
Other receivables	1,657,544
Pledges receivable—net	31,323,702
Cash and cash equivalents held for long-term purposes	52,436,452
Financial assets, at year-end	<u>137,764,045</u>
Less those unavailable for general expenditure within one year:	
Funds restricted for capital projects	(51,186,441)
Cash held for others—ship bank	(1,074,996)
Pledges receivable, expected to be collected in more than one year	(9,970,367)
Pledges receivable, restricted for capital projects	(21,353,335)
Donor restricted endowment	(1,187,000)
Unappropriated endowment income	(47,857)
Unavailable	<u>(84,819,996)</u>
Financial assets available to meet cash needs for general expenditures within one year	<u>\$ 52,944,049</u>

As part of the Mercy Ships' liquidity management, it has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due. Mercy Ships has two lines of credit with financial institutions, both in the amount of \$5,000,000, maturing June 30, 2019 and November 14, 2019, respectively. To date, Mercy Ships has not made any draws on the line of credits. These funds could be used to fund operations if required.

# MERCY SHIPS AND AFFILIATES

## Notes to Consolidated and Combined Financial Statements

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December 31, 2017 (Summarized Financial Information)

4. PLEDGES RECEIVABLE–NET:

Pledges receivable–net, consist of:

	December 31,	
	2018	2017
Due in less than one year	\$ 21,353,335	\$ 37,225,377
Due in one to five years	11,906,947	7,848,656
	<u>33,260,282</u>	<u>45,074,033</u>
Less: present value discount	(244,913)	(263,226)
Less: allowance for uncollectible promises	<u>(1,691,667)</u>	<u>(2,251,302)</u>
	<u>\$ 31,323,702</u>	<u>\$ 42,559,505</u>

During the years ended December 31, 2018 and 2017, Mercy Ships received new pledges receivable of \$22,323,641 and \$23,458,500, respectively; approximately \$2,360,000 and \$1,000,000, respectively, of these pledges being from board members, and received payments of \$34,043,281 and \$4,652,467, 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.

5. INVENTORY:

Inventory consists of the following:

	December 31,	
	2018	2017
Medical supplies	\$ 3,645,458	\$ 2,530,947
Fuel	543,838	449,310
Food	257,158	176,418
Other	<u>387,342</u>	<u>101,539</u>
	<u>\$ 4,833,796</u>	<u>\$ 3,258,214</u>

# MERCY SHIPS AND AFFILIATES

## Notes to Consolidated and Combined Financial Statements

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6. PROPERTY AND EQUIPMENT–NET:

Property and equipment consists of:

	December 31,	
	2018	2017
Land and buildings	\$ 10,310,255	\$ 10,172,007
Ship and related improvements	67,438,610	67,202,747
Tools and equipment	2,938,411	2,814,834
Vehicles	1,362,276	1,552,761
Medical equipment	3,868,679	4,131,544
	85,918,231	85,873,893
Less accumulated depreciation	(48,606,183)	(45,396,227)
	37,312,048	40,477,666
Assets not placed into service	65,976,541	49,331,495
	\$ 103,288,589	\$ 89,809,161

7. NET ASSETS WITHOUT DONOR RESTRICTIONS:

Net assets without donor restrictions consist of:

	December 31,	
	2018	2017
Available for operations	\$ 27,210,228	\$ 20,637,435
Equity in property and equipment–net	101,391,292	87,644,421
Equity in inventory–net	4,833,796	3,258,214
Quasi endowments	15,154	14,782
	\$ 133,450,470	\$ 111,554,852

# MERCY SHIPS AND AFFILIATES

## Notes to Consolidated and Combined Financial Statements

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December 31, 2017 (Summarized Financial Information)

### 8. NET ASSETS WITH DONOR RESTRICTIONS BY PURPOSE OR TIME:

Net assets with donor restrictions by purpose or time consist of:

	December 31,	
	2018	2017
Capital project–new ship:		
Funds received, not spent	\$ 51,186,441	\$ 29,587,481
Pledges made, not received	31,323,702	42,559,505
	<u>82,510,143</u>	<u>72,146,986</u>
M/V Africa Mercy	10,578,452	10,496,022
Maxillofacial/plastic surgery projects	1,784,265	3,000,769
Mercy vision projects	1,934,974	1,631,147
Orthopedic projects	832,661	867,396
Women’s health projects	1,196,371	731,196
Non-surgical projects	1,347,903	666,475
General surgery projects	2,661,509	476,651
Dental projects	380,210	336,095
Crew assistance fund	10,117	133,364
Other ministry projects (including unappropriated endowment income)	54,188	544,075
	<u>\$ 103,290,793</u>	<u>\$ 91,030,176</u>

# MERCY SHIPS AND AFFILIATES

## Notes to Consolidated and Combined Financial Statements

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December 31, 2017 (Summarized Financial Information)

### 9. ENDOWMENT FUNDS AND RELATED ASSETS:

Assets held for endowment funds consist of:

	December 31,	
	2018	2017
Cash and cash equivalents	\$ 1,250,011	\$ 1,049,888

Net assets with donor restrictions in perpetuity consist of:

	December 31,	
	2018	2017
Crew assistance fund	\$ 107,000	\$ 107,000
Operations	80,000	80,000
Technical training	1,000,000	800,000
	<u>\$ 1,187,000</u>	<u>\$ 987,000</u>

The endowment net asset composition by type of fund as of December 31, 2018:

	Without donor restrictions	With donor restrictions		Total
		gains (losses) and other	Original gift amount	
Donor restricted endowment funds	\$ -	\$ 47,857	\$ 1,187,000	\$ 1,234,857
Board-designated endowment funds	15,154	-	-	15,154
	<u>\$ 15,154</u>	<u>\$ 47,857</u>	<u>\$ 1,187,000</u>	<u>\$ 1,250,011</u>

Changes in endowment net assets for the year ended December 31, 2018:

	Without donor restrictions	With donor restrictions		Total
		gains (losses) and other	Original gift amount	
Endowment net assets, beginning of year	\$ 14,782	\$ 48,106	\$ 987,000	\$ 1,049,888
Investment income (loss)	372	(249)	-	123
Contributions	-	-	200,000	200,000
Endowment net assets, end of year	<u>\$ 15,154</u>	<u>\$ 47,857</u>	<u>\$ 1,187,000</u>	<u>\$ 1,250,011</u>

# MERCY SHIPS AND AFFILIATES

## Notes to Consolidated and Combined Financial Statements

December 31, 2018

December 31, 2017 (Summarized Financial Information)

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

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

	Without donor restrictions	With donor restrictions		Total
		gains (losses) and other	Original gift amount	
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:

	Without donor restrictions	With donor restrictions		Total
		gains (losses) and other	Original gift amount	
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

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 net assets without donor restrictions. As of December 31, 2018 and 2017, there are no deficiencies resulting from unfavorable market fluctuations, respectively.

### 10. 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, 2018 and 2017.

# MERCY SHIPS AND AFFILIATES

## Notes to Consolidated and Combined Financial Statements

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December 31, 2017 (Summarized Financial Information)

### 11. 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,	
	2018	2017
Australia	\$ 1,429,225	\$ 1,397,084
Belgium	2,469,615	1,912,972
Canada*	583,112	882,105
Germany	1,918,695	1,650,962
Holland	3,943,065	3,316,557
Norway**	1,756,160	1,838,302
Switzerland	4,134,980	2,924,820
United Kingdom	4,850,355	3,080,117
	<u>\$ 21,085,207</u>	<u>\$ 17,002,919</u>

\*The transfers from Mercy Ships Canada were in support of programs conducted by Mercy Ships in fulfillment of the Joint Programs Agreements between Mercy Ships and Mercy Ships Canada.

\*\*Includes funds donated by Norad.

# MERCY SHIPS AND AFFILIATES

## Notes to Consolidated and Combined Financial Statements

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December 31, 2017 (Summarized Financial Information)

### 12. 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, 2018 and 2017, net assets of non-U.S. operations were 6.7% and 7.4% 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, 2018 and 2017, 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.

### 13. SUBSEQUENT EVENTS:

Subsequent events have been evaluated through May 16, 2019, which represents the date the consolidated and combined financial statements were available to be issued. Subsequent events after that date have not been evaluated.