MERCY CORPS AND AFFILIATES

Consolidated Financial Statements
and Supplemental Schedules

June 30, 2017

(With Independent Auditors' Report Thereon)

MERCY CORPS AND AFFILIATES

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KPMG LLP
Suite 3800
1300 South West Fifth Avenue
Portland, OR 97201

Independent Auditors' Report

The Board of Directors
Mercy Corps and affiliates:

We have audited the accompanying consolidated financial statements of Mercy Corps and affiliates, which comprise the consolidated statement of financial position as of June 30, 2017, and the related consolidated statements of activities, cash flows, and functional expenses for the year then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated 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 financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the consolidated 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 financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Mercy Corps and affiliates as of June 30, 2017, and the changes in their net assets and cash flows for the year then ended, in accordance with U.S. generally accepted accounting principles.

Report on Summarized Comparative Information

We have previously audited Mercy Corps and affiliates 2016 consolidated financial statements, and we expressed an unmodified audit opinion on those consolidated financial statements in our report dated December 7, 2016. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2016 is consistent, in all material respects, with the audited consolidated financial statements from which it has been derived.

Other Matter

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplemental information included in schedules I and II is presented for purposes of additional analysis and is not a required part of the consolidated 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 financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated 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 financial statements or to the consolidated 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 financial statements as a whole.

KPMG LLP

Portland, Oregon
November 10, 2017

MERCY CORPS AND AFFILIATES

Consolidated Statement of Financial Position

June 30, 2017
With comparative financial information as of June 30, 2016

(In thousands)

Assets		**2017**	**2016**
Cash and cash equivalents	$	132,226	114,476
Financial instruments and derivatives, net		796	2,050
Grants and accounts receivable		44,641	45,402
Microfinance loans receivable, net		69,210	62,364
Inventories and material aid		800	2,765
Prepaid expenses, deposits, and other assets		6,647	7,776
Pledges receivable, net		561	616
Investments		18,061	15,635
Program-related investments		2,829	4,494
Property and equipment, net		40,160	40,704
Total assets	$	315,931	296,282
Liabilities and Net Assets			
Liabilities:			
Accounts payable and accrued liabilities	$	52,907	35,562
Deferred revenue		84,363	68,070
Customer deposits for microfinance activities		15,487	4,232
Subsidiary and subordinated debt for microfinancing activities		47,537	79,786
Long-term debt		9,782	10,017
Total liabilities		210,076	197,667
Net assets:			
Unrestricted:			
Controlling interests		81,383	70,547
Noncontrolling interests		7,277	6,997
Total unrestricted		88,660	77,544
Temporarily restricted		17,195	21,071
Total net assets		105,855	98,615
Total liabilities and net assets	$	315,931	296,282

See accompanying notes to consolidated financial statements.

MERCY CORPS AND AFFILIATES

Consolidated Statement of Activities

Year ended June 30, 2017
With summarized financial information for the year ended June 30, 2016

(In thousands)

	Unrestricted	Temporarily restricted	Total	2016 Total
Operating support and revenue:				
Public support and revenue:				
Government grants	$ 285,912	—	285,912	279,625
Material aid	1,238	—	1,238	4,928
Material aid – monetized	574	—	574	1,860
Total public support and revenue	287,724	—	287,724	286,413
Private support and revenue:				
Other grants	99,871	—	99,871	82,305
Contributions	30,165	8,420	38,585	40,324
Gifts in kind	1,726	—	1,726	663
Bequests	7,494	—	7,494	1,623
Total private support and revenue	139,256	8,420	147,676	124,915
Other revenue:				
Interest income	23,896	—	23,896	24,386
Other revenue	1,280	—	1,280	909
Total other revenue	25,176	—	25,176	25,295
Net assets released from restriction	12,296	(12,296)	—	—
Total operating support and revenue	464,452	(3,876)	460,576	436,623
Operating expenses:				
Program services:				
Humanitarian assistance – relief	139,876	—	139,876	162,553
Humanitarian assistance – recovery	46,699	—	46,699	15,152
Livelihood/economic development	124,292	—	124,292	118,587
Civil society and education	50,210	—	50,210	50,384
Health	31,318	—	31,318	30,502
Total program services	392,395	—	392,395	377,178
Supporting services:				
General and administrative	44,963	—	44,963	41,790
Resource development	18,003	—	18,003	15,849
Total supporting services	62,966	—	62,966	57,639
Total operating expenses	455,361	—	455,361	434,817
Change in net assets from operations	9,091	(3,876)	5,215	1,806
Nonoperating revenue and losses net:				
Foreign currency exchange loss, net	(862)	—	(862)	(1,879)
Realized and unrealized gain on investments, net	4,104	—	4,104	3,973
Unrealized loss on swap agreements	(1,217)	—	(1,217)	(3,463)
Total nonoperating revenue and losses net	2,025	—	2,025	(1,369)
Change in net assets before other interests	11,116	(3,876)	7,240	437
Purchase of interest by noncontrolling shareholder	—	—	—	567
Contribution from MCE	—	—	—	6,397
Change in net assets	11,116	(3,876)	7,240	7,401
Net assets at beginning of year	77,544	21,071	98,615	91,214
Net assets at end of year	$ 88,660	17,195	105,855	98,615

See accompanying notes to consolidated financial statements.

MERCY CORPS AND AFFILIATES

Consolidated Statement of Cash Flows

Year ended June 30, 2017
With comparative financial information for the year ended June 30, 2016

(In thousands)

		2017	2016
Cash flows from operating activities:			
Change in net assets	$	7,240	7,401
Adjustments to reconcile change in net assets to net cash provided by operating activities:			
Depreciation and amortization		3,248	3,502
Provision for loan losses		894	693
Net realized and unrealized gain or loss on investments		(4,685)	(2,993)
Forgiveness of debt		(185)	447
Unrealized loss (gain) on foreign exchange arrangements and financial instruments		1,903	3,544
Contribution from MCE		—	20,812
Gain on disposition of fixed assets		26	705
Changes in assets and liabilities:			
Grants and accounts receivable		761	(14,512)
Due from unconsolidated affiliates, net		—	(352)
Inventories		1,965	4,125
Prepaid expenses, deposits, and other assets		1,129	(449)
Pledges receivable		55	643
Customer deposits for microfinance activities		11,255	4,232
Accounts payable and accrued liabilities		17,345	(10,101)
Deferred revenue		16,293	12,106
Net cash provided by operating activities		57,244	29,803
Cash flows from investing activities:			
Purchase of investments		(5,612)	(10,649)
Proceeds from sale of investments		8,833	8,195
Issuances of microfinance loans		(91,204)	(97,016)
Repayments on microfinance loans		83,646	106,038
Acquisition of property and equipment		(3,200)	(5,222)
Disposition of property and equipment		526	443
Net cash (used in) provided by investing activities		(7,011)	1,789
Cash flows from financing activities:			
Capital contributions		—	567
Proceeds from borrowings by microfinance entities		7,559	70,124
Repayments on borrowings of microfinance entities		(39,807)	(61,404)
Issuance of long term debt		920	120
Repayments on long-term debt		(1,155)	(406)
Net cash (used in) provided by financing activities		(32,483)	9,001
Net increase in cash and cash equivalents		17,750	40,593
Cash and cash equivalents at beginning of year		114,476	73,883
Cash and cash equivalents at end of year	$	132,226	114,476
Supplemental disclosures:			
Interest paid during the year	$	8,731	8,869
Noncash contributions		3,538	7,368

See accompanying notes to consolidated financial statements.

MERCY CORPS AND AFFILIATES

Consolidated Statement of Functional Expenses

Year ended June 30, 2017
With summarized financial information for the year ended June 30, 2016

(In thousands)

	Program services						Support services			
	Humanitarian assistance – relief	Humanitarian assistance – recovery	Livelihood/ economic development	Civil society and education	Health	Total program services	General and administration	Resource development	Total expenses	2016 Total
Personnel	$ 34,588	10,432	41,669	17,950	12,015	116,654	31,422	6,833	154,909	142,357
Professional services	8,269	1,921	11,021	2,267	1,401	24,879	2,890	2,131	29,900	21,672
Travel and vehicle expense	5,206	1,893	5,259	2,451	2,137	16,946	5,070	640	22,656	21,793
Office and occupancy expense	4,495	1,637	6,909	2,131	1,846	17,018	3,831	4,346	25,195	24,556
Other operating expenses	1,298	459	654	389	137	2,937	437	3,831	7,205	7,808
Material aid	—	46	—	—	821	867	—	—	867	5,187
Materials and supplies	21,753	7,085	7,381	2,472	2,848	41,539	31	—	41,570	60,039
Construction, nonowned assets	6,034	1,158	3,117	7,990	2,071	20,370	—	—	20,370	21,079
Training, monitoring, and evaluation	1,732	1,185	4,075	4,345	1,885	13,222	14	—	13,236	15,427
Subgrants	56,324	20,822	32,878	9,908	6,019	125,951	—	—	125,951	99,157
Microfinancing activity	—	—	10,254	—	—	10,254	—	—	10,254	12,207
Depreciation	177	61	1,075	307	138	1,758	1,268	222	3,248	3,535
	$ 139,876	46,699	124,292	50,210	31,318	392,395	44,963	18,003	455,361	434,817

See accompanying notes to consolidated financial statements.

(1) Organization and Purpose

(a) Business and Organization

Mercy Corps, headquartered in Portland, Oregon, is incorporated under the laws of the State of Washington as a nonprofit corporation. Mercy Corps' mission is to alleviate suffering, poverty, and oppression by helping people build secure, productive, and just communities around the globe.

Mercy Corps is a global organization, 5,000 strong, powered by the belief that a better world is possible. Mercy Corps helps people survive and get back on their feet when natural disaster strikes, economies collapse or conflict erupts. Where there are chronic threats to peace and progress, Mercy Corps partners with communities to overcome obstacles and thrive.

Mercy Corps employees live and work in more than 40 countries facing the world's toughest challenges. For more than three decades, Mercy Corps has worked alongside more than 170 million extraordinary people to strengthen their communities from within. In everything we do, Mercy Corps looks for moments of transition to connect people to resources and expertise that can catalyze transformative change.

The consolidated financial statements include the accounts of Mercy Corps Global and its controlled affiliates or under common control affiliates. Mercy Corps Global, a Washington nonprofit corporation (MCG) and affiliates, are collectively referred to herein as the Organization. All material intercompany transactions and balances have been eliminated. Consolidated affiliates include:

Mercy Corps Europe (MCE)
Asian Credit Public Fund
Hunchun Association for Poverty Alleviation in the Tumen River Area
Kompanion Development Institution
Kompanion Financial Group Microfinance Closed Joint Stock Company
MC Nigeria LTD/GTE (Nigeria)
Mercy Corps China Holdings, LLC
Mercy Corps Development Holdings, LLC
Mercy Corps India
Mercy Enterprise Corporation d/b/a Mercy Corps Northwest
Mercy Corps Liaoning Holdings, LLC
Yanbian Association for Poverty Alleviation in the Tumen River Area
Mercy Corps Condominium Unit Owners Association (inactive)
Mercy Corps Foundation
Mercy Corps International Jordan

Entities deconsolidated, dissolved, or in dissolution as of June 30, 2017:

Yayasan Microfinance Innovation & Resource Center Foundation (deconsolidated June 2017)
Yayasan Mercy Corps Indonesia (deconsolidated January 2017)
MC Morocco, LLC (in dissolution June 2017)
MC Egypt, LLC (in dissolution June 2016)
Mercy Corps Investment Fund, LLC (dissolved June 2016)

(2) Summary of Significant Accounting Principles

(a) Basis of Accounting

The accompanying consolidated financial statements of the Organization have been prepared on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles.

Net assets are classified based on the existence or absence of donor-imposed restrictions. Accordingly, the Organization's net assets and changes therein are classified and reported as follows:

- Unrestricted net assets – Net assets that are not subject to donor-imposed restrictions
- Temporarily restricted net assets – Net assets that are subject to donor-imposed restrictions that permit the Organization to use or expend the assets as specified. The restrictions are satisfied either by the passage of time or by actions of the Organization.
- Permanently restricted net assets – Net assets that are subject to donor-imposed restrictions that are maintained in perpetuity by the Organization unless an action by the donor or courts removes the restriction

(b) Use of Estimates

The preparation of consolidated financial statements, in conformity with accounting principles generally accepted in the United States, requires management to make estimates and assumptions that affect the reported assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Significant estimates in the Organization's consolidated financial statements include loan loss reserves, fair value of investments, and functional expense allocations. Actual results may differ from those estimates.

(c) Revenue Recognition

Contributions, including unconditional promises to give, are recognized initially at fair value as revenue in the period received at net realizable value. Contribution revenue is reported as an increase in unrestricted net assets unless their use is limited by donor-imposed restrictions.

Funds provided under grant or contract, which are not considered contributions, are deemed to be earned and reported as revenue when the Organization has either incurred expenditures or completed the deliverables in compliance with the specific terms and conditions of the grant or contract. Grant or contract funds received for which no corresponding expenditure or performance has yet been made are accounted for as deferred revenue. Expenditures and performance made in advance of funds received are recorded as grants and accounts receivable.

Donated services that meet the criteria for recognition in accordance with generally accepted accounting principles are reported as gift-in-kind services and expenses in amounts equal to their estimated fair value on the date of receipt. Approximately $1,017 and $593 of legal services were provided pro bono to the Organization in 2017 and 2016, respectively. Gifts in kind of software and travel credits are reported at fair value on the date of receipt and included in Gifts in kind.

Commodities are received and reported at fair value and recognized as revenue as the commodities are distributed for program purposes.

Gifts in kind and contributions of fixed assets and materials for program purposes are reported as contributions at their estimated fair values on the date of receipt and reported as expense when utilized.

(d) Functional Allocation of Expenses

The Organization allocates expenses on a functional basis among its various programs and supporting services. Expenses that can be identified with a specific program or supporting service are charged directly. Other expenses that are common to several functions are allocated by various statistical bases.

(e) Change in Net Assets from Operations

Change in net assets from operations excludes activities that Mercy Corps considers to be outside the scope of its primary business, as defined by its mission statement.

(f) Foreign Currency Translation

Assets and liabilities denominated in foreign currencies are translated into U.S. dollars at the exchange rate in effect on reporting dates, and revenue and expenses are translated at rates that approximate the average rate for the period in which the transactions occurred. Net transaction and translation gains and losses are included in the accompanying statements of activities in the nonoperating revenue and expenses section as foreign currency exchange gain or loss.

(g) Income Taxes

The Organization has been granted tax-exempt status under Section 501(c)(3) of the Internal Revenue Code and corresponding sections of the state of Washington provisions as a publicly supported organization, which is not a private foundation.

Accounting principles generally accepted in the United States of America require Mercy Corps' management to evaluate tax positions taken by Mercy Corps and recognize a tax liability (or asset) if Mercy Corps has taken an uncertain position that more likely than not would not be sustained upon examination by the Internal Revenue Service (IRS). Management has analyzed tax positions taken by Mercy Corps and has concluded that as of June 30, 2017, there are no uncertain positions taken or expected to be taken that would require recognition of liability (or asset) or disclosure in the consolidated financial statements. Mercy Corps is subject to routine audits by taxing jurisdictions; however, there are currently no IRS audits for any tax periods in progress.

(h) Cash

Cash consists of short-term, highly liquid investments with original maturities of three months or less at the date of acquisition.

(Continued)

Per donor terms and internal processes, project related cash is held in accounts separate from the primary operating accounts. These types of segregated accounts totaled $72,151 and $53,124 at June 30, 2017 and 2016, respectively.

(i) Investments

The Organization holds various types of investments, including money market accounts, mutual funds and managed accounts. Investments are recorded at fair value. Interest earned on funds is included in interest income. Dividends are included in other revenue. There are no significant concentrations as the investment portfolio is diversified among issuers.

(j) Charitable Gift Annuities

The Organization has a certificate of authority from the State of Oregon and from the State of Washington and a few other states to receive transfers of money or property upon agreement to pay an annuity. The annuity liability included in accounts payable and accrued liabilities as of June 30, 2017 and 2016 was $740 and $728, respectively. The Organization maintains segregated accounts for all gift annuities. The amounts in the accounts were $934 and $883 as of June 30, 2017 and 2016, respectively. No annuity contracts have been issued in the State of Washington as of June 2017.

(k) Derivative Financial Instruments

Derivative financial instruments held by the Organizations' subsidiaries include back-to-back loans, which have the contractual effect of a currency swap or interest rate swap. The swap counter-parties to these transactions have no recourse to the Organization. Derivatives are initially recognized at fair value on the date on which the derivative contract is entered into and are subsequently remeasured at fair value. All derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative. Changes in the fair value are recognized currently as an unrealized gain or loss on swap agreements in nonoperating revenue and expenses, net.

(l) Fair Value Measurements

The Organization applies the Accounting Standard Codification (ASC) 820, *Fair Value Measurement*, which established a framework for measuring fair value. This standard defines the fair value as the amount that would be exchanged for an asset or to transfer a liability in an orderly transaction between market participants at the measurement date.

The standard establishes a three-level fair value hierarchy that prioritizes the valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

Level 1 – Unadjusted quoted or published prices in active markets that are accessible at the measurement date for identical assets or liabilities

Level 2 – Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted market prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the whole term of the assets or liabilities

Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the asset or liability. Unobservable inputs are used to measure fair value to the extent that observable inputs are not available.

The Organization used the following methods and significant assumptions to estimate fair value for its assets measured and carried at fair value in the consolidated financial statements:

Investments – Fair values for these investments are based on quoted market or published prices (Level 1).

Derivative financial instruments – The fair value of microfinance institution's derivatives are based on estimates using standard pricing models that take into account the present value of future cash flows as of the date of the statements of financial position. The fair values of the interest and currency rate swaps are based on models that rely on observable market-based data (Level 2).

(m) Grants and Accounts Receivable

The majority of the Organization's grants and accounts receivable are due from government and multilateral agencies and private foundations. Grants and accounts receivable are expected to be collected within one year and are recorded at net realizable value.

Pledges receivable and notes receivable that are expected to be collected in future years are recorded at fair value at the date of the contribution, as determined using the net present value of estimated future cash flows. In subsequent periods, the discount rate is unchanged and the allowance for uncollectible contributions is reassessed and adjusted if necessary. Amortization of the discounts is recorded as additional contribution revenue.

(n) Microfinance Loans Receivable

Financial services are an essential element of the Organization's integrated approach to helping people. In this sector, the Organization has established microfinance institutions (MFIs), structured loan guarantee programs, built capacity in existing MFIs and created service organizations to contribute to the development of the overall microfinance industry. Activities from these services are reported as livelihood/economic development program expense in the consolidated statements of activities, and it is the Organization's intent to reinvest all proceeds generated back into mission-related programs.

Mercy Corps owns or controls 50% or more of the following MFIs and MFI technical assistance organizations and they are thus consolidated in the accompanying consolidated financial statements.

Kompanion Financial Group Microfinance Closed Joint Stock Company (Kompanion), a for-profit entity, was formed in 2004 in the Kyrgyz Republic to engage in microfinance activities. Mercy Corps is the founder and majority shareholder of Kompanion. In February 2015, Kompanion issued additional shares to a third party, resulting in a 65% ownership interest for Mercy Corps.

Hunchun Association for Poverty Alleviation in the Tumen River Area and the Yanbian Association for Poverty Alleviation in the Tumen River Area (collectively, the PATRAs) were formed in 2002 and 2003, respectively, as a means toward the alleviation of poverty and suffering in certain areas in China. These organizations are registered under Chinese law and are considered local projects of Mercy Corps. Under a Memorandum of Understanding, Mercy Corps controls the PATRA entities.

In 2001, Mercy Corps established Mercy Enterprise Corporation (MEC), dba Mercy Corps Northwest, as a nonprofit corporation under the laws of the State of Oregon in order to provide economic development services to low-income populations in the states of Oregon and Washington. Mercy Corps maintains control of the board of directors along with control and management of MEC’s programs.

Microfinance loans receivable are recorded in the consolidated statements of financial position at their unpaid principal balances net of allowance for loan losses. Interest income is accrued based on the outstanding principal amount and contractual terms of each individual loan. The affiliated organizations review their loans to assess impairment on a regular basis. A loan is considered impaired when, based on current information, it is probable that the MFIs will not receive all amounts due in accordance with the contractual terms of the underlying loan agreement. When an impairment loss has been incurred, the amount of the loss is measured as the difference between the carrying amount of the loan receivable and the present value of the estimated future cash flows, including amounts recoverable from guarantees and collateral discounted at the loan receivable’s original effective interest rate. All loan receivable losses are recognized in the consolidated statements of activities. When a loan is uncollectible, it is written off against the related reserve for loan impairment. Loan balances are written off when management determines that the loans are uncollectible and when all necessary steps to collect the loan are exhausted.

(o) Inventories and Material Aid

The Organization receives agricultural commodities from governments for distribution via Organization programs and for monetization in which proceeds of the commodity sale are to be used to fund Organization programs. Commodities received for distribution are recorded at estimated fair value as inventory and deferred revenue. Revenue is recognized as inventory is distributed and is recorded in the consolidated statements of activities as “Material Aid.” Funds received from monetization of commodities are deferred until utilized in program activities and are then recorded in the consolidated statements of activities as "Material Aid-Monetized."

Material Aid commodities received from the U.S. government that are held for sale are valued at the lesser of the fair value on the contribution date or the expected sales price in the foreign location, if impaired. Material Aid commodities held for distribution and not for sale are valued at estimated fair value.

(p) Program-Related Investments

Program-related investments represent the Organization's investments in domestic and overseas organizations that do not meet the standard of control for consolidation under U.S. generally accepted accounting principles. The investments are typically in the form of equity investments funded with grants or the Organization's unrestricted funds. The primary purpose of these investments is the furtherance of the Organization's mission rather than the generation of income. Investments are recorded on either the cost or equity method, depending on the Organization's level of ownership and influence over the entities.

(q) Property and Equipment, Net

Land, buildings, and equipment are stated at acquisition cost or fair value on the date of contribution. Depreciation is computed on a straight-line basis over the shorter of the estimated useful lives of the respective assets or the related lease term. The estimated useful lives by asset class are as follows:

	Years
Buildings	30–39
Leasehold improvements	3–30
Furniture, fixtures, and equipment	3–10
Vehicles	3–5

The Organization has adopted a policy of applying a time restriction that expires over the useful life of the long-lived assets acquired, or constructed with contributions restricted for that purpose, and therefore, releases amounts from temporarily restricted net assets ratably over the same useful life.

(r) Reclassifications

Certain reclassifications have been made to prior years' amounts to conform to the current year's presentation.

(s) Comparative Financial Information

The accompanying consolidated financial statements include certain prior year summarized information. With respect to the consolidated statements of functional expenses, information from the prior year is presented in the aggregate and not presented by function. Accordingly, such information should be read in conjunction with the Organization's prior year consolidated financial statements from which the summarized information was derived.

(t) New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers*, to clarify the principles for recognizing revenue and to improve financial reporting by creating common revenue recognition guidance for U.S. generally accepted accounting principles and International Financial Reporting Standards. The amendments in the ASU can be applied either retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying the update recognized at the date of the initial application along with additional disclosures. The new standard is effective for Mercy Corps on July 1, 2019. The Organization is currently evaluating the extent of the anticipated impact of the adoption of ASU 2014-09.

In February 2016, the FASB issued ASU No. 2016-02, *Leases*, which requires lessees to recognize a lease liability and a right of use asset for all lease obligations with exception for short-term leases. The lease liability will represent the lessee's obligation to make lease payments arising from the lease measured on a discounted basis and the right of use asset will represent the lessee's right to use or control the use of a specified asset for a lease term. The new standard is effective for Mercy Corps on July 1, 2020. The Organization is currently evaluating the extent of the anticipated impact of the adoption of ASU 2016-02.

In August 2016, the FASB issued ASU No. 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*, with the intent to reduce diversity in reporting practice, reduce complexity, and enhance understandability of not-for-profit (NFP) financial statements. This ASU contains the following key aspects: (A) reduces the number of net asset classes presented from three to two: with donor restrictions and without donor restrictions; (B) requires all NFPs to present expenses by their functional and their natural classifications in one location in the financial statements; (C) requires NFPs to provide quantitative and qualitative Information about management of liquid resources and availability of financial assets to meet cash needs within one year of the balance sheet date; and (D) retains the option to present the statement of cash flows using either the direct or indirect method. The new standard is effective for Mercy Corps on July 1, 2018. The Organization is currently evaluating the extent of the anticipated impact of the adoption of ASU 2016-02.

(Dollars in thousands)

(3) Fair Value of Financial Instruments and Investments

Fair value measurements for the assets measured at fair value on a recurring basis at June 30, 2017 consisted of the following:

		Level 1	Level 2	Total
Assets:				
Investments:				
Mutual funds – equity	$	5,608	—	5,608
Mutual funds – fixed income		6,792	—	6,792
Foreign government securities		5,385	—	5,385
Real estate investment trust		276	—	276
Total investments		18,061	—	18,061
Derivative financial instruments:				
Foreign currency swap arrangements		—	796	796
Total	$	18,061	796	18,857

Fair value measurements for the assets measured at fair value on a recurring basis at June 30, 2016 consisted of the following:

		Level 1	Level 2	Total
Assets:				
Investments:				
Mutual funds – equity	$	4,955	—	4,955
Mutual funds – fixed income		5,254	—	5,254
Foreign government securities		5,131	—	5,131
Real estate investment trust		295	—	295
Total investments		15,635	—	15,635
Derivative financial instruments:				
Foreign currency swap arrangements		—	2,050	2,050
Total	$	15,635	2,050	17,685

Mercy Corps had no Level 3 assets or liabilities measured at fair value at June 30, 2017 and 2016.

(Continued)

(Dollars in thousands)

(4) Pledges Receivable

Unconditional promises to give are included in the consolidated financial statements as pledges receivable and revenue of the appropriate net asset category. Pledges receivable are expected to be collected in future years and are recorded after discounting to the present value of expected future cash flows.

Unconditional promises are expected to be collected in the following periods:

		2017	2016
One year or less	$	407	362
Between one year and five years		171	272
		578	634
Less:			
Discount		(17)	(18)
Pledges receivable, net	$	561	616

(5) Microfinance Loans Receivable

Microfinance loans comprise variable and fixed-rate loans with individuals and groups. Group loans are unsecured loans granted to a group of borrowers who sign a loan agreement with joint and several liability to repay a loan. The loans bear interest at rates generally at or below the local market industry average available. Microfinance loans are issued with original maturities ranging from 3 to 36 months.

Microfinance loans receivable were concentrated in the following countries as of June 30, 2017 and 2016:

		2017	2016
China	$	1,452	1,621
Kyrgyzstan		72,100	64,440
United States		446	430
		73,998	66,491
Less loan loss reserves		(4,788)	(4,127)
Microfinance loans receivable, net	$	69,210	62,364

The Organization applies ASC Topic 310, *Receivables*, for financing receivables and the corresponding allowance for losses.

(Dollars in thousands)

Allowances for estimated losses are established based on prior collection experience and observed trends in the rate of default, as well as a consideration of current economic trends and indicators. Loan balances are written off when they are deemed to be ultimately uncollectible.

Changes in allowance for estimated losses on financing receivables as of June 30, 2017 and 2016 are presented as follows:

		2017	2016
Loan loss reserve, beginning	$	(4,127)	(3,898)
Adjustments to reserve		(894)	(687)
Write-off		233	473
Recovery		—	(15)
Loan loss reserve, ending	$	(4,788)	(4,127)

The reserves noted above can be attributed to loans that are current or past due as follows at June 30, 2017:

		Current	Past due	Total
Microfinance loans receivable	$	71,380	2,618	73,998
Less loan loss reserves		(3,313)	(1,475)	(4,788)
Microfinance loans receivable, net	$	68,067	1,143	69,210

The reserves noted above can be attributed to loans that are current or past due as follows at June 30, 2016:

		Current	Past due	Total
Microfinance loans receivable	$	63,936	2,555	66,491
Less loan loss reserves		(2,635)	(1,492)	(4,127)
Microfinance loans receivable, net	$	61,301	1,063	62,364

(Dollars in thousands)

(6) Property and Equipment

		2017	2016
Land	$	4,407	4,407
Buildings and leasehold improvements		40,898	40,171
Vehicles		10,979	10,556
Furniture, fixtures, and equipment		11,564	11,056
Property and equipment		67,848	66,190
Less accumulated depreciation and amortization		(27,688)	(25,486)
Property and equipment, net	$	40,160	40,704

(7) Program-Related Investments

The Organization's program-related investments at June 30 are as follows:

		2017	2016
PT Bank Andara, Indonesia	$	—	2,453
ACF MCO, LLC, Kazakhstan		1,266	1,005
Kompanion Invest, Kyrgystan		—	251
MICRO		217	54
MEVCF		180	131
MCDH		1,166	600
	$	2,829	4,494

PT Bank Andara (Andara), a limited liability company, was organized under the laws of the Republic of Indonesia in 2009 by an investor consortium, led by Mercy Corps. Mercy Corps founded Andara to deliver innovative financial services to millions of low-income Indonesian families. Andara serves as the strategic banking partner to the Indonesian microfinance sector, which encompasses over 50,000 institutions. At June 30, 2016, the Organization owned 22% of the outstanding shares of Andara. Mercy Corps sold 100% of its shares in Andara in two tranches during 2017. The sale agreement included a transfer of interest as well as a put option for all shareholders. The put option was exercised on May 17, 2017. The value of the shares was $2,453 on June 30, 2016 and the total proceeds were $6,078, resulting in a realized gain on investment of $3,625 during 2017, which is included in realized and unrealized gain on investments in the Statement of Activities.

At June 30, 2017 and 2016 Mercy Corps owned 30% of Asian Credit Fund Micro Credit Organization LLC (ACF MCO LLC) directly and reports this investment on an equity basis.

(Dollars in thousands)

Kompanion Invest LLC was formed in Kyrgyzstan in October 2011 to provide a bank based on the Shariah principles. The organization is owned 99.9% by Kompanion. Kompanion Invest LLC is now consolidated by Kompanion, and therefore, Mercy Corps' interest is eliminated upon consolidation of Kompanion.

MiCRO Insurance Catastrophe Risk Organization SCC (MiCRO – SCC) was formed on March 17, 2011. Their focus is to engage in providing micro-insurance products and services to achieve poverty alleviation in Central America and elsewhere in the Caribbean region by providing insurance protection to the economically disadvantaged in the event of natural disasters. At June 30, 2016, Mercy Corps owned 25% of the shares in MiCRO. During 2017 Mercy Corps contributed an additional $444 as gift in kind and an outside investor contributed $200 which brought Mercy Corps' investment to 34.6% at June 30, 2017. Mercy Corps reports the investment in MiCRO-SCC on an equity basis.

In fiscal 2011, Mercy Corps invested in the Middle East Venture Capital Fund, L.P. (MEVCF). The purpose of MEVCF is a venture capital fund focusing primarily on stimulating economic development by making investments in medium-sized businesses in the information and communications technology sectors. At June 30, 2017 and 2016, Mercy Corps owned less than 2% of this fund. The investment is recorded on a cost basis.

Mercy Corps Development Holdings, LLC (MCDH) invests in start – up program related social ventures. At June 30, 2017, MCDH had $550k in equity and $616K in convertible notes invested in ten ventures in Columbia, Indonesia and Africa. This investment is recorded on a cost basis.

Mercy Corps has other small investments in various entities recorded on a cost basis. These investments allow Mercy Corps to partner with developing social enterprises, consistent with its mission.

(8) Debt

At June 30, debt consisted of the following:

		2017	2016
U.S. Bank, N.A.	$	8,632	8,887
NW Bank		920	—
Beneficial Bank		—	900
Other debt		230	230
Total	$	9,782	10,017

(Dollars in thousands)

Future maturities of debt outstanding at June 30, 2017 are as follows:

2018	$	312
2019		342
2020		351
2021		589
2022		7,623
Thereafter		565
Total	$	9,782

2017 Line of Credit

The Organization has a $4,000 line of credit commitment with a bank for working capital purposes, which bears interest at 2% above the daily one-month LIBOR when drawn upon. The line is collateralized by a security interest in the Organization’s accounts receivable, inventory, and equipment. On March 27, 2017, MCG renewed the line of credit. MCG increased the size of the line from $3,500 to $4,000 to reflect the growth in business. MCG also extended the term to March 1, 2020 and increased the uncommitted fee to 50 basis points from 35 basis points. During 2017 and 2016, there were no borrowings during the year, and as of June 30, 2017 and 2016, the Organization has no outstanding borrowings under the line of credit. The line of credit contains certain restrictive covenants that require, among other things, that the Organization maintain a fixed charge coverage ratio and minimum levels of unrestricted cash and cash equivalents.

Mercy Corps is the sole party to the line of credit.

2015 Tax Exempt Bonds

On June 25, 2015, the Organization, through Oregon Facilities Authority, issued a tax exempt bond to U.S. Bank, N.A. The proceeds were used to refinance the debt of the HQ building in Portland, OR and purchase a portion of the building that was owned by another party through a condo arrangement. The promissory note is collateralized by the property it finances and contains certain restrictive covenants that require, among other things, that the Organization maintain a minimum liquidity ratio. The interest rate is 3.07% until June 30, 2022, payable in monthly principal and interest installments of $44. At that time, the promissory note may be refinanced at a new rate at the option of U.S. Bank N.A., or a balloon payment will be due on June 30, 2022. The final maturity of the U.S. Bank N.A. promissory note is June 30, 2029.

Mercy Corps is the sole party to the promissory note.

MEC Debt

On June 6, 2017, Plaza 122, a subsidiary of Mercy Enterprise Corporation entered into a 7 year mortgage with Northwest Bank for $920 at a fixed rate of 5.93%, with a balloon payment of the outstanding balance due in June, 2024. The Northwest Bank mortgage refinanced the Beneficial Bank

(Continued)

(Dollars in thousands)

$900 mortgage. The mortgage is collateralized by the property it finances. In addition, two impact investors have provided Plaza 122 with a total of $230 at a rate of 4.00%. The loans are secured and subordinated to the Northwest Bank mortgage. The debt matures on January 1, 2021 in a balloon payment.

(9) Subsidiary and Subordinated Debt for Microfinancing Activities

Microfinancing debt is primarily used to finance the Organization's microfinance lending activities. Typically, this debt is not collateralized and principal payments are expected to be made from the flow of cash from collection of the loan receivables. Mercy Corps does not guarantee the repayment on this debt. Payment terms on these loans vary.

Microfinancing debt maturities as of June 30, 2017 were as follows:

Year ending		Kompanion	MEC	Total
2018	$	17,608	222	17,830
2019		15,201	84	15,285
2020		8,556	171	8,727
2021		523	47	570
2022		2,331	15	2,346
Thereafter		2,470	309	2,779
Total	$	46,689	848	47,537

The above debt represents obligations of the following subsidiaries of Mercy Corps:

		2017	2016
Mercy Enterprise Corporation	$	848	1,110
Kompanion		46,689	78,676
	$	47,537	79,786

(Dollars in thousands)

Interest rates of subsidiary microfinancing borrowings at June 30, 2017 are as follows:

Subsidiary	Lender	Interest rates	Due date		Balance
Mercy Enterprise Corporation	Various	0.00%–2.00%	2017-beyond	$	848
Kompanion	BistumEssen	6.75 %	2020		2,027
Kompanion	BlueOrchard	6.75%–21.50%	2017		1,587
Kompanion	NBKR	10.00 %	2017		1,310
Kompanion	EBRD	5.8%–18.37%	2018-2020		6,109
Kompanion	Global Commercial	6.90 %	2019		1,008
Kompanion	Microvest	6.00 %	2019		2,009
Kompanion	Incofin	6.25 %	2017		1,670
Kompanion	MinFIn	8.00%–12.00%	2020-2033		2,724
Kompanion	Global Impact	6.00 %	2020		2,006
Kompanion	Oikocredit	17.50 %	2017		1,594
Kompanion	RES	6.75%–24.75%	2019		8,531
Kompanion	FMO	10.00 %	2019		7,852
Kompanion	Symbiotics	6.8%–7%	2017		2,010
Kompanion	Triodos	7.25 %	2018		3,048
Kompanion	Triplejump	10.50 %	2020		824
Kompanion	State Mortgage Co	5%–7%	2032		1,583
Kompanion	Russian-Kyrgyz Development Fund	8.00 %	2021-2022		797
				$	47,537

The above debt also includes subordinated debts of $1,054 and $827, at June 30, 2017 and 2016, respectively. This subordinated debt is subordinate to all other debt of the individual subsidiary. The subordinated debt maturity dates range from 2017 to 2033; however, the actual maturity dates are automatically extended each year unless the lender exercises its rights to set the final maturity date.

(10) Temporarily Restricted Net Assets

Temporarily restricted net assets available for programs are $10,575 and $14,292 as of June 30, 2017 and 2016, respectively. Temporarily restricted net assets available for the headquarters building are $6,620 and $6,779 as of June 30, 2017 and 2016, respectively.

(Dollars in thousands)

(11) Obligations under Operating Leases

The Organization leases office space, housing and equipment under operating leases that require payments through 2024. The leases may contain annual escalation clauses at fixed percentages or based on the consumer price index. At June 30, 2017, the Organization's aggregate minimum annual operating lease commitments are as follows:

FY18	$	1,608
FY19		1,272
FY20		961
FY21		909
Thereafter		1,698
Total	$	6,448

Total rent expense was $4,757 and $4,398 for the fiscal years ended June 30, 2017 and 2016, respectively.

(12) Commitments and Contingencies

The Organization receives a substantial portion of its funding in the form of grants from government and multilateral agencies. These grants contain certain compliance and internal control requirements that, if violated, may result in the disallowance of certain costs incurred under the grant programs. Additionally, the Organization is involved in various legal proceedings and claims arising in the normal course of business. The Organization adjusts the contingent liabilities each year based on settlement of accrued amounts and potential liabilities that are reasonably likely and estimable. At June 30, 2017 and 2016, the Organization had total accrued contingent liabilities of $2,282 and $1,933, respectively.

While it is not possible to determine the ultimate liability, if any, in these matters at this time, in the opinion of management, such matters will not have a material adverse effect on the financial condition of the Organization in excess of the recorded contingent liability.

(13) Employee Benefit Plan

MCG has a defined-contribution plan under Internal Revenue Code Section 403(b) for employees who meet the eligibility conditions. Employees are eligible to make voluntary pretax contributions beginning the first day of the month following their employment date. Employees are eligible to receive employer contributions equal to 6% of gross salary after one year of service. The Organization's contributions to the plan for the years ended June 30, 2017 and 2016 amounted to $1,542 and $1,471, respectively.

MCG also has a nonqualified employee benefit plan for certain third-country nationals who are otherwise ineligible for the defined-contribution plan under Internal Revenue Code Section 403(b). These employees receive employer contributions equal to 6% of gross salary after one year of service. The Organization accrues liabilities for the program on a monthly basis. The liability accrued for the program for the years ended June 30, 2017 and 2016 amounted to $463 and $440, respectively. At June 30, 2017 and 2016, the Organization had total accrued liabilities for this plan of $1,782 and $1,509, respectively.

(Continued)

Mercy Corps Europe contributes to defined-contribution pension plans on behalf of employees. The assets of the plans are held separately from those of the company. Contributions are charged to the income and expenditure account and the statement of financial activities in the period in which they are incurred.

Within the various countries in which the Organization operates outside the United States and the United Kingdom, most employees are citizens of the host country. These employees are not eligible for the Organization’s defined-contribution plan or for the employee benefit plan for third-country nationals; however, they may be eligible for certain local government sponsored plans appropriate for that country.

(14) Significant Sources of Revenue and Concentration of Risk

(a) Significant Sources of Revenue

The Organization receives a majority of its funding through grants from government agencies. A reduction in the amount of grants available or in the Organization’s ability to receive government grants would have a material impact on its programs and operations.

(b) Concentration of Risk

For cash held in the United States, the Organization maintains its cash in commercial banks that are in excess of the Federal Deposit Insurance Company (FDIC) limits. Management believes the risk associated with balances in excess of FDIC limits is minimal.

For cash held in the United Kingdom, the Organization maintains cash in commercial banks that are in excess of U.K. deposit insurance limits. Management believes the risk associated with the balance in excess of the deposit insurance limits is minimal.

In order to fulfill grant agreements and maintain ongoing operations in foreign countries, the Organization maintains cash balances in both regional and local currencies. The Organization had cash deposits of 13.9% and 23.1%, in the Organization’s foreign locations. Of the cash held in foreign locations, 11.3% and 47.4% was held by the Organization’s MFI’s, as of June 30, 2017 and 2016, respectively.

(15) Subsidiary Entities

The Organization is required to consolidate certain entities under the guidance of FASB ASC Topic 810, *Consolidation*. However, MCG has limitations on the use of the assets and is not obligated for the liabilities of these consolidated subsidiaries under the laws in place in the foreign jurisdiction of each of these subsidiaries and under the terms of the entities’ bylaws.

Mercy Corps continues to establish new entities to invest in new technology, business models, and social enterprises to provide transformational opportunities for overcoming poverty. The following entities are yet to have significant activities, but are controlled by Mercy Corps and have therefore been consolidated as of June 30, 2017:

Mercy Corps India was formed in August 2010 as joint-stock company to carry out operations in India.

Mercy Corps Egypt, LLC was formed in 2012 to establish a field office and operations and began dissolution in 2016.

Yayasan Mercy Corps Indonesia was formed in February 2012 to further the mission in Indonesia. This entity was deconsolidated in January 2017.

Kompanion Development was formed in 2008 to assist with development in Kyrgyzstan.

Mercy Corps China Holdings, LLC was formed in 2013 to own a Chinese wholly owned foreign enterprise established under Chinese law to provide services in furtherance of the Mercy Corps mission.

MC Morocco, LLC was formed in August 2014 to develop, implement, and manage projects in the areas of economic development, youth, and civil society. This entity was deconsolidated in June 2017.

MICRA Indonesia was formed in 2007 to support microfinance activities through trainings, workshops, and rating and research in the microfinance sector. This entity was deconsolidated in June 2017.

Mercy Corps Development Holdings, LLC was formed in 2015 as a for-profit holding entity and facilitates impact investing for seed and early stage venture start-ups that create economic opportunities for underserved populations.

Mercy Corps Liaoning Holdings, LLC was formed in 2016 to own a Chinese wholly owned foreign enterprise under Chinese law to provide services in furtherance of Mercy Corps mission.

The total combined net assets of the nine entities listed above are $1,431 and $1,180 as of June 30, 2017 and 2016, respectively.

(16) Subsequent Events

The Organization has performed an evaluation of subsequent events through November 10, 2017, which is the date the consolidated financial statements were available to be issued, and has determined there are no additional disclosures needed.

The following schedules I and II are a presentation of the financial position and financial activities and changes in net assets for MCG on an unconsolidated basis. These amounts are included as part of the consolidated financial statements of Mercy Corps and affiliates for the fiscal year ended June 30, 2017.

Schedule I

MERCY CORPS GLOBAL

Supplemental Schedule – Mercy Corps Statement of Financial Position

Year ended June 30, 2017
With comparative financial information as of June 30, 2016

(In thousands)

Assets		**2017**	**2016**
Cash	$	74,007	57,514
Grants and accounts receivable		25,908	14,987
Due from unconsolidated affiliates, net		13,505	12,075
Inventories		800	2,765
Prepaid expenses, deposits, and other assets		5,616	6,788
Pledges receivable, net		561	616
Investments		12,676	10,503
Program-related investments		17,216	18,880
Property and equipment, net		33,002	33,899
Total assets	$	183,291	158,027
Liabilities and Net Assets			
Liabilities:			
Accounts payable and accrued liabilities	$	40,282	29,740
Deferred revenue		45,265	37,508
Long-term debt		8,631	8,887
Total liabilities		94,178	76,135
Net assets:			
Unrestricted		71,946	60,875
Temporarily restricted		17,167	21,017
Total net assets		89,113	81,892
Total liabilities and net assets	$	183,291	158,027

See accompanying independent auditors' report.

Schedule II

MERCY CORPS GLOBAL

Supplemental Schedule – Mercy Corps Statement of Activities

Year ended June 30, 2017
With comparative financial information for the year ended June 30, 2016

		Unrestricted	Temporarily restricted	Totals	2016 Total
Operating support and revenue:					
Public support and revenue:					
Government grants	$	184,604	—	184,604	204,592
Material aid		1,238	—	1,238	4,918
Material aid – monetized		574	—	574	1,860
Total public support and revenue		186,416	—	186,416	211,370
Private support and revenue:					
Other grants		82,559	—	82,559	70,348
Contributions		28,694	8,420	37,114	35,835
Gift in kind		1,335	—	1,335	443
Bequests		6,742	—	6,742	1,623
Total private support and revenue		119,330	8,420	127,750	108,249
Other revenue:					
Interest income		318	—	318	323
Other revenue		800	—	800	473
Total other revenue		1,118	—	1,118	796
Net assets released from restriction		12,270	(12,270)	—	—
Total operating support and revenue		319,134	(3,850)	315,284	320,415
Operating expenses:					
Program services:					
Humanitarian assistance – relief		89,485	—	89,485	131,044
Humanitarian assistance – recovery		46,699	—	46,699	15,153
Livelihood/economic development		68,381	—	68,381	69,726
Civil society and education		28,283	—	28,283	32,262
Health		23,223	—	23,223	23,216
Total program services		256,071	—	256,071	271,401
Supporting services:					
General and administrative		39,714	—	39,714	37,917
Resource development		16,748	—	16,748	14,806
Total supporting services		56,462	—	56,462	52,723
Total operating expenses		312,533	—	312,533	324,124
Change in net assets from operations		6,601	(3,850)	2,751	(3,709)
Nonoperating revenue and expenses, net:					
Foreign currency exchange loss, net		(99)	—	(99)	(449)
Realized and unrealized gain on investments, net		4,569	—	4,569	4,271
Gain on forgiveness of debt		—	—	—	13,798
Total nonoperating revenue and expenses, net		4,470	—	4,470	17,620
Change in net assets		11,071	(3,850)	7,221	13,911
Net assets at beginning of year		60,875	21,017	81,892	67,981
Net assets at end of year	$	71,946	17,167	89,113	81,892

See accompanying independent auditors' report.