

HEART TO HEART INTERNATIONAL, INC.

FINANCIAL STATEMENTS

Year Ended December 31, 2013



INDEPENDENT AUDITORS' REPORT

To the Board of Directors

HEART TO HEART INTERNATIONAL, INC.

We have audited the accompanying financial statements of Heart to Heart International, Inc., which comprise the statement of financial position as of December 31, 2013 and the related statements of activities, functional expenses and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 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 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 financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 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 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 financial statements referred to above present fairly, in all material respects, the financial position of Heart to Heart International, Inc. as of December 31, 2013, and the changes in its net assets and cash flows for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

Prior Period Adjustment

As discussed in Note 13 to the financial statements, as of December 31, 2012, \$15,139,078 was not included in the final inventory listing although accounting records indicate that the inventory was received prior to December 31, 2012. As a result, a prior period adjustment was recorded to reflect donated inventory on hand as of December 31, 2012. Our opinion is not modified with respect to that matter.

Leawood, Kansas
July 17, 2014

Mayer Hoffman McCann P.C.



HEART TO HEART INTERNATIONAL, INC.

STATEMENT OF FINANCIAL POSITION

December 31, 2013

ASSETS

CURRENT ASSETS	
Cash and cash equivalents	\$ 1,084,651
Inventory	11,146,793
Pledges receivable	329,225
Other current assets	<u>5,283</u>
TOTAL CURRENT ASSETS	12,565,952
PROPERTY AND EQUIPMENT, at cost, less accumulated depreciation	1,495,779
INVESTMENTS	<u>65,868</u>
TOTAL ASSETS	<u>\$ 14,127,599</u>

LIABILITIES

CURRENT LIABILITIES	
Accounts payable	\$ 72,511
Accrued liabilities	100,352
Current portion of long-term debt	<u>53,467</u>
TOTAL CURRENT LIABILITIES	226,330
LONG-TERM DEBT, less current portion above	<u>1,034,618</u>
TOTAL LIABILITIES	<u>1,260,948</u>

NET ASSETS

UNRESTRICTED NET ASSETS	11,744,011
TEMPORARILY RESTRICTED NET ASSETS	1,056,772
PERMANENTLY RESTRICTED NET ASSETS	<u>65,868</u>
TOTAL NET ASSETS	<u>12,866,651</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 14,127,599</u>

See Notes to Financial Statements

HEART TO HEART INTERNATIONAL, INC.

STATEMENT OF ACTIVITIES

Year Ended December 31, 2013

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
SUPPORT AND REVENUE				
Gifts in kind	\$ 89,157,523	\$ -	\$ -	\$ 89,157,523
Contributions	1,113,373	1,155,166	-	2,268,539
Donated shipping	1,139,555	-	-	1,139,555
Governmental and corporate grants	529,536	517,395	-	1,046,931
Program revenue	894,369	-	-	894,369
Investment income	608	-	2,713	3,321
Rent income	11,270	-	-	11,270
Gain on currency conversion	12,208	-	-	12,208
Other income	103	-	-	103
Net assets released from restrictions	1,624,411	(1,624,411)	-	-
TOTAL SUPPORT AND REVENUE	94,482,956	48,150	2,713	94,533,819
EXPENSES				
Program services - international	131,071,840	-	-	131,071,840
Program services - domestic	5,092,997	-	-	5,092,997
General and administrative	781,540	-	-	781,540
Fundraising and public relations	670,604	-	-	670,604
TOTAL EXPENSES	137,616,981	-	-	137,616,981
CHANGES IN NET ASSETS	(43,134,025)	48,150	2,713	(43,083,162)
NET ASSETS, BEGINNING OF YEAR, as restated	54,878,036	1,008,622	63,155	55,949,813
NET ASSETS, END OF YEAR	\$ 11,744,011	\$ 1,056,772	\$ 65,868	\$ 12,866,651

See Notes to Financial Statements

HEART TO HEART INTERNATIONAL, INC.
STATEMENT OF FUNCTIONAL EXPENSES

Year Ended December 31, 2013

	Program Services			Fundraising	Total
	International Projects	Domestic Projects	General and Administrative		
Customs and fees	\$ 50,974	\$ 414	\$ 713	\$ 1,753	\$ 53,854
Distributed aid	49,455	9,422	13,423	-	72,300
Donated medical services	624,954	294,096	-	-	919,050
Donated rent	-	11,270	-	-	11,270
Donated shipping	375,830	763,725	-	-	1,139,555
Insurance	-	202	22,130	603	22,935
Interest	31,261	4,755	6,417	9,205	51,638
Inventory valuation adjustments	276,549	21,165	-	-	297,714
Maintenance and repairs	64,332	3,014	2,335	245	69,926
Medical and contract services	159,385	89	25,058	52,875	237,407
Office	64,569	5,238	42,318	52,098	164,223
Postage and shipping	12,292	391	4,603	16,767	34,053
Printing and artwork	564	1,392	878	12,998	15,832
Professional fees	6,036	-	66,755	4,581	77,372
Publicity	-	170	-	2,632	2,802
Rent	23,377	1,630	49,985	10,301	85,293
Salaries and benefits	899,673	126,799	470,715	419,102	1,916,289
Special events	-	-	-	10,767	10,767
Staff development	2,372	6	565	267	3,210
Telephone	39,378	6,161	17,730	12,273	75,542
Travel and meals	483,456	6,251	54,953	52,443	597,103
Warehouse	93,505	12,991	252	132	106,880
Expenses before depreciation and gifts-in-kind distributed	3,257,962	1,269,181	778,830	659,042	5,965,015
Depreciation	24,972	147,618	2,710	11,562	186,862
Gifts-in-kind distribution	127,788,906	3,676,198	-	-	131,465,104
TOTAL EXPENSES	\$ 131,071,840	\$ 5,092,997	\$ 781,540	\$ 670,604	\$ 137,616,981
	95.24%	3.70%	0.57%	0.49%	100.00%

See Notes to Financial Statements

HEART TO HEART INTERNATIONAL, INC.

STATEMENT OF CASH FLOWS

Year Ended December 31, 2013

CASH FLOWS FROM OPERATING ACTIVITIES

Changes in net assets	\$ (43,083,162)
Adjustments to reconcile changes in net assets to net cash flows from operating activities	
Depreciation	186,862
Realized and unrealized gain on investments	(2,713)
Decrease (increase) in operating assets	
Inventory	43,508,739
Pledges receivable	(1,849)
Other current assets	(266,332)
Increase (decrease) in operating liabilities	
Accounts payable	(4,459)
Accrued liabilities	9,961
NET CASH FLOWS FROM OPERATING ACTIVITIES	<u>347,047</u>

CASH FLOWS FROM INVESTING ACTIVITIES

Acquisition of property and equipment	(188,854)
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CASH FLOWS FROM FINANCING ACTIVITIES

Repayment of long-term debt	<u>(552,138)</u>
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NET CHANGE IN CASH AND CASH EQUIVALENTS (393,945)

CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR 1,478,596

CASH AND CASH EQUIVALENTS, END OF YEAR \$ 1,084,651

HEART TO HEART INTERNATIONAL, INC.

NOTES TO FINANCIAL STATEMENTS

(1) Summary of significant accounting policies

Organization – Heart To Heart International, Inc. (the Organization), a Kansas non-profit corporation, provides crisis response assistance and specific ongoing health care support to communities in need domestically and internationally. The Organization actively engages the services of volunteers through its initiatives, and it distributes medical supplies, pharmaceuticals and other products to other relief agencies and communities in need.

The Organization currently operates and supports more than a dozen clinics in Haiti. The Organization responded after the earthquake in January 2010 and continues to work towards healthier communities in Haiti – providing continuing medical education and other needs in Haiti.

The Organization's donor base for cash contributions primarily consists of individuals, businesses, civic groups and foundations located throughout the United States. Gifts-in-kind are also received primarily from medical supply and pharmaceutical companies located throughout the United States.

Basis of accounting – The Organization's financial statements are prepared on the accrual basis of accounting.

Basis of presentation – In accordance with the limitations, designations and restrictions placed on the use of resources available to the Organization, the following classifications are utilized according to the nature and purpose of the resources:

Unrestricted Net Assets: Net assets that are not subject to donor-imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of the Organization's Board of Directors or may otherwise be limited by contractual agreements with outside parties.

Temporarily Restricted Net Assets: Net assets whose use by the Organization is subject to donor-imposed or legal stipulations that can be fulfilled by actions of the Organization pursuant to those stipulations or that expire by the passage of time. Amounts received that are designated for future periods or restricted by the donor for specific purposes are reported as temporarily restricted. Temporarily restricted net assets are released from restriction when the expenses are incurred for their designated purpose. Support that is restricted by the donor is reported as an unrestricted contribution if the restriction expires in the reporting period in which the support is recognized.

Permanently Restricted Net Assets: Net assets subject to donor-imposed stipulations and those which are interpreted by the Board of Directors that are maintained permanently by the Organization. Generally, the donors of these assets permit the Organization to use all or part of the income earned on these assets. Earnings on permanently restricted net assets that are to be expended in accordance with the desires of donors are recorded as temporarily restricted net assets. Once expenses are incurred for their donor-restricted purpose, the earnings are released from restriction.

Income taxes – The Organization is exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code as a not-for-profit organization. In addition, the Organization has been classified as a publicly-supported organization which is not a private foundation within the meaning of Section 509(a)(1) of the Code. Accordingly, no provision has been made for Federal income tax.

The Organization's present accounting policy for the evaluation of uncertain tax positions is to review those positions on an annual basis. A liability would be recorded in the financial statements during the period which, based on all available evidence, believes it is more likely than not that the tax position would not be sustained upon examination by taxing authorities and the liability would be incurred by the Organization. No accrual has been recorded at December 31, 2013, as management does not believe any material uncertainties exist.

HEART TO HEART INTERNATIONAL, INC.

NOTES TO FINANCIAL STATEMENTS

(1) **Summary of significant accounting policies (continued)**

Cash and cash equivalents - Cash and cash equivalents consist of available cash balances on deposit at financial institutions and short-term money market investments.

Concentration of risk – The Organization maintains its cash balances in two financial institutions located in the greater Kansas City, Kansas area. The Organization’s domestic cash accounts are fully insured by the Federal Deposit Insurance Corporation. Effective January 1, 2013, these accounts were insured up to \$250,000 per bank. The Organization also has two checking accounts in Haiti that are uninsured. Accordingly, at December 31, 2013, the Organization’s uninsured cash and cash equivalents amounts to \$483,191.

Inventory – Purchased inventory is recorded at the lower of cost or market and is valued on a first-in, first-out basis. Donated inventory is recorded at the fair value of the donated goods at the date of donation based upon the estimated wholesale value of gifts received (as further described in Note 1 under “Revenue Recognition”). The inventory is not available for sale. The Organization records a loss for the decrease in value of any slow-moving or expired inventory.

Investments – The Organization carries its investments at their fair values. Unrealized gains and losses are included in the change in net assets.

Property and equipment – Property and equipment are stated at cost or the fair market value at date of gift for donated assets, less accumulated depreciation. If a donor stipulates how long the assets must be used, the contribution is recorded as restricted support. In the absence of such stipulation, a contribution of property and equipment is recorded as unrestricted support. Maintenance and repairs are charged to expense as incurred. When items of property and equipment are sold or retired, the related cost is removed from the accounts and any gain or loss is included in the results of operations. Depreciation is computed using the straight-line method over the estimated useful lives of the assets as follows:

<u>Assets</u>	<u>Estimated Useful Lives</u>
Building and improvements	15 – 39 years
Furniture and equipment	5 – 7 years
Computer equipment	3 – 5 years
Leasehold improvements	3 years
Vehicles	3 – 10 years

Fair value of financial instruments – The carrying amounts of financial instruments including cash and cash equivalents, receivables, accounts payable and accrued liabilities approximated fair values as of December 31, 2013 due to their short-term nature. The carrying amount of notes payable approximated fair value due to similar available terms.

HEART TO HEART INTERNATIONAL, INC.

NOTES TO FINANCIAL STATEMENTS

(1) Summary of significant accounting policies (continued)

Gifts-in-kind – Donated inventory, buildings and equipment are recorded at their estimated fair value at the date of gift. A number of unpaid volunteers have made significant contributions of their time to the activities of the Organization without compensation. In addition, the Organization receives contributed professional services from several individuals in the field of medicine. These amounts are reflected at fair value in the financial statements which amounted to \$919,050 for the year ended December 31, 2013. In addition, approximately 18,000 volunteer hours were provided to the Organization during the year ended December 31, 2013 for which no value has been assigned.

Gifts-in-kind: Donated shipping – The Organization recorded \$1,139,555 in shipping expense for overseas and domestic freight during the year ended December 31, 2013. The donated shipping is also included in Unrestricted Support and Revenue.

Revenue recognition – Cash and gift-in-kind contributions are received from individuals as well as domestic and multinational organizations. These contributions, including unconditional promises, are recognized as revenues when the donor's unconditional commitment is received. All contributions are considered to be available for unrestricted use unless specifically restricted by the donor. Conditional promises to give are recognized only when the conditions on which they depend are substantially met.

The Organization receives donations of medical supplies and other goods for use in its programs. These donations are recorded at their estimated fair value based upon the Organization's estimate of the wholesale values that would be received for selling the goods in their principal market, considering their condition and utility for use at the time the goods are donated. Several methodologies are used in the determination of estimated wholesale value, including values provided by the donor, published industry pricing guides, internally-researched values, and internal average values for like-kind items.

The Organization receives many volunteer hours from a variety of skilled personnel such as doctors, nurses and other specialists. The value of these donated services that meets the criteria for recognition is reported as donated services in the accompanying Statement of Activities. Contributed service time meets the criteria to be recorded in the financial statements if it requires specialized skills, the service is being provided by an individual who possesses those skills and if the service would typically need to be purchased if not contributed.

Use of estimates – The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The significant estimates used in the Organization's financial statements include the valuation of gift-in-kind contributions and related inventory, the allocation of expenses on a functional basis to various program services and supporting activities and the estimated useful lives of, and the methods used, to depreciate property and equipment.

Functional expenses - The costs of providing the various programs and other activities have been summarized on a functional basis in the statement of activities. Certain costs have been allocated among the programs and supporting services benefited as depicted in the accompanying statement of functional expenses. Expenses that can be identified with a specific program and support are allocated directly according to their natural expenditure classification. Other expenses that are common to several functions are allocated by management's estimate of resources devoted to the programs or support source. Direct benefit to donor costs have been included in fundraising costs on the statement of functional expenses as the associated costs are not material in relation to the financial statements taken as a whole.

HEART TO HEART INTERNATIONAL, INC.

NOTES TO FINANCIAL STATEMENTS

(2) Unconditional promises to give

Unconditional promises to give that are expected to be collected in future years are recorded at the present value of their estimated future cash flows. The discounts on those amounts are computed using interest rates applicable to the years in which the promises are received. The discount rate used in valuing unconditional promises to give was 4%. Amortization of the discounts is included in contribution revenue.

In less than one year	\$	175,000
In one to five years		175,000
		<u>350,000</u>
Less present value discount		<u>(20,775)</u>
Total unconditional promises to give	\$	<u><u>329,225</u></u>

(3) Inventory

Inventory consists of the following at December 31:

Pharmaceutical supplies	\$	7,074,678
Medical and other supplies		<u>4,072,115</u>
Total inventory	\$	<u><u>11,146,793</u></u>

(4) Fair value measurements of assets and liabilities

FASB Accounting Standards Codification 820-10, *Fair Value Measurements and Disclosures* (ASC 820-10), requires additional disclosures as part of the financial statements. ASC 820-10 establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The three levels are defined as follows:

Level 1 – Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets.

Level 2 – Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 – Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

HEART TO HEART INTERNATIONAL, INC.

NOTES TO FINANCIAL STATEMENTS

(4) Fair value measurements of assets and liabilities (continued)

The following table sets forth information about the level within the fair value hierarchy at which the Organization's financial assets and liabilities were measured on a recurring basis at December 31, 2013:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Assets:				
Trading securities	\$ 52,311	\$ -	\$ -	\$ 52,311
Beneficial interest in community foundation	-	-	13,557	13,557
Total assets - recurring basis	<u>\$ 52,311</u>	<u>\$ -</u>	<u>\$ 13,557</u>	<u>\$ 65,868</u>

The management of the Organization endeavors to utilize the best available information in measuring fair value. Fair value for the Organization's trading securities was determined by using Level 1 valuation methods. Fair value for the Organization's interest in the common funds of a community foundation was determined using Level 3 valuation methods. The Level 3 investments were based upon stated values obtained from a community foundation.

(5) Investments

Investments consist of the following at December 31:

Equity securities	\$ 8,232
Fixed income	4,674
Stock and bond mutual funds	22,091
Money market funds	30,871
Total investments	<u>\$ 65,868</u>

Investment return is as follows:

Interest and dividends	\$ 608
Realized and unrealized gains (losses) on investments	2,713
Total investment return	<u>\$ 3,321</u>

HEART TO HEART INTERNATIONAL, INC.

NOTES TO FINANCIAL STATEMENTS

(6) Property and equipment

Property and equipment consists of the following at December 31:

Cost	
Land	\$ 161,000
Buildings	344,000
Warehouse	575,000
Building improvements	622,640
Furniture and equipment	211,800
Computer equipment	439,709
Construction in process	141,421
Vehicles	<u>607,678</u>
Total cost	3,103,248
Accumulated depreciation	<u>1,607,469</u>
Net property and equipment	<u><u>\$ 1,495,779</u></u>

(7) Long-term debt

The Organization's obligation under notes payable consists of the following:

Note payable, secured by real property, monthly payments of \$6,090, including interest at 4.0%, due January, 2014.	\$ 889,085
Note payable, secured by real property, interest only payments at 5.5%, principal due May 2016.	199,000
Total debt	<u>1,088,085</u>
Less current portion	<u>(902,085)</u>
Non-current debt	<u><u>\$ 186,000</u></u>

Subsequent to December 31, 2013, the Organization refinanced the debt with the January 2014 maturity into two new notes payable. As a result of this refinancing, the resulting debt totals \$1,093,000. The first note payable has an original principal of \$743,750, with a fixed rate of interest at 5.24% for a period of five years. The Organization will pay monthly payments of principal and interest of \$5,038, with a final balloon payment in the amount of \$629,180 due February 27, 2019. The second note payable has an original principal balance of \$150,250, with a fixed rate of interest at 5.74% for a period of five years. The Organization will pay monthly payments of principal and interest of \$2,892 with a final payment due February 27, 2019.

The maturity schedule below includes the effects of the refinancing transaction that occurred subsequent to December 31, 2013, but prior to the issuance of the financial statements.

HEART TO HEART INTERNATIONAL, INC.

NOTES TO FINANCIAL STATEMENTS

(7) Long-term debt (continued)

Years ending December 31,

2014	\$ 53,467
2015	64,074
2016	226,963
2017	57,017
2018	60,242
Thereafter	<u>631,237</u>
Total	<u><u>\$ 1,093,000</u></u>

The total amount of interest paid during the year was \$51,638.

(8) Leases

The Organization leases office space in Olathe, Kansas. The lease expires August 31, 2014. Rent payments totaled \$62,840 for the year ended December 31, 2013. The future minimum annual lease payments are anticipated to be \$42,448 for the year ended December 31, 2014.

(9) Restricted net assets

Restricted net assets consist of funds held for the following purposes:

Temporarily Restricted Net Assets:

Global Crisis Response	\$ 586,114
Joplin, Missouri	<u>470,658</u>
Total Temporarily Restricted Net Assets	<u><u>\$ 1,056,772</u></u>

Permanently Restricted Net Assets:

Heart to Heart International Endowment Fund	\$ 13,557
Staff Development	2,000
General	<u>50,311</u>
Total Permanently Restricted Net Assets	<u><u>\$ 65,868</u></u>

The sources of net assets released from temporary donor restrictions by incurring expenses satisfying the restricted purpose or by occurrence of events specified by the donors were as follows:

Net Assets Released from Temporary Restrictions:

Global Crisis Response	\$ 1,410,814
Joplin, Missouri	30,587
U.S. Programs	40,682
General Disaster	<u>142,328</u>
Total Net Assets Released from Temporary Restrictions	<u><u>\$ 1,624,411</u></u>

HEART TO HEART INTERNATIONAL, INC.

NOTES TO FINANCIAL STATEMENTS

(10) **Endowment fund**

The Organization has contributed total assets of \$13,557 to The Greater Kansas City Community Foundation and Affiliated Trusts (the Foundation), which established the Heart to Heart International Endowment Fund (the Fund). The purpose of the fund is to serve as an endowment for the Organization and its successors, with the annual net income to be distributed to the Organization. The Fund is donor-advised, whereby the Foundation seeks input from the Organization regarding distribution of grants from the principal. The assets are refundable to the Organization upon request.

(11) **Significant gift-in-kind contributors**

The Organization receives a significant portion of its gifts-in-kind contributions from pharmaceutical and medical supply companies. Three companies provided approximately 81% of the gifts-in-kind contributions in 2013.

(12) **Rental income**

The Organization recorded \$11,270 in rental income as it provides space rent-free to another not-for-profit organization at its warehouse. Approximately 6,000 square feet is used for storage and 16,400 for office space. The donated rent is also included in Program services-Domestic expenses.

(13) **Prior period adjustment**

The net assets as of December 31, 2012 have been restated from the amount previously reported. Donated inventory that was received as gift-in-kind revenue prior to December 31, 2012 was not recorded in the 2012 financial statements. The effect of this restatement is as follows:

Net assets at December 31, 2012, as previously reported	\$ 40,810,735
Adjustment to record donated inventory received as gift-in-kind revenue in the period in which it was received	<u>15,139,078</u>
Net assets at December 31, 2012, as restated	<u>\$ 55,949,813</u>

(14) **Subsequent events**

The Organization has evaluated subsequent events through July 17, 2014, which is the date the financial statements were available to be issued. No significant matters were identified for disclosure during this evaluation, except as described in Note 7 related to the refinancing of long-term debt.