



**DIRECT RELIEF INTERNATIONAL
(A NON-PROFIT CORPORATION)**

**Independent Auditor's Report
and
Accompanying Financial Statements**

March 31, 2004

**DIRECT RELIEF INTERNATIONAL
(A NON-PROFIT CORPORATION)**

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INDEPENDENT AUDITOR'S REPORT

Board of Directors
Direct Relief International
Santa Barbara, California

We have audited the accompanying statements of financial position of Direct Relief International, a non-profit corporation, as of March 31, 2004 and the related statements of activities, changes in net assets, functional expenses and cash flows for the three months then ended. These financial statements are the responsibility of Direct Relief International's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the accompanying financial statements referred to above present fairly, in all material respects, the financial position of Direct Relief International at March 31, 2004 and the results of its operations for the three months then ended, in conformity with generally accepted accounting principles in the United States of America.

December 21, 2004
Santa Barbara, California

Larson & Ridge LLP
Larson & Ridge LLP
Certified Public Accountants

**DIRECT RELIEF INTERNATIONAL
(A NON-PROFIT CORPORATION)
STATEMENT OF FINANCIAL POSITION
MARCH 31, 2004**

	Unrestricted Funds	Temporarily Restricted Funds	Permanently Restricted Funds	Total All Funds March 31, 2004
Assets				
Current assets:				
Cash and cash equivalents	\$ 454,822	\$ 179,946	\$ -	\$ 634,768
Investments in marketable securities	4,698,154	20,131		4,718,285
Contributions receivable	42,466	8		42,474
Inventories	15,590,089			15,590,089
Prepaid expenses	39,485			39,485
Total Current Assets	<u>20,825,016</u>	<u>200,085</u>	<u>-</u>	<u>21,025,101</u>
 Property and equipment - net of accumulated depreciation of \$610,744	 3,073,896			 3,073,896
Contributions receivable from remainder unitrusts	41,173			41,173
Investment in real estate	530,000			530,000
Other assets	18,260			18,260
Total assets	<u>\$ 24,488,345</u>	<u>\$ 200,085</u>	<u>\$ -</u>	<u>\$ 24,688,430</u>
Liabilities and Net Assets				
Current liabilities:				
Accounts payable	\$ 76,009	\$ -	\$ -	\$ 76,009
Current portion of long-term debt	46,793			46,793
Other current liabilities	144,557			144,557
Total current liabilities	<u>267,359</u>	<u>-</u>	<u>-</u>	<u>267,359</u>
 Long-term debt	1,568,346			1,568,346
Distribution payable - split interest agreements	-	33,546		33,546
Total liabilities	<u>1,835,705</u>	<u>33,546</u>	<u>-</u>	<u>1,869,251</u>
 Net assets:				
Unrestricted net assets:				
Board designated endowment fund	5,011,156			5,011,156
Undesignated	17,641,484			17,641,484
Total unrestricted net assets	<u>22,652,640</u>	<u>-</u>	<u>-</u>	<u>22,652,640</u>
 Temporarily restricted net assets		166,539		166,539
Total net assets	<u>22,652,640</u>	<u>166,539</u>	<u>-</u>	<u>22,819,179</u>
 Total liabilities and net assets	<u>\$ 24,488,345</u>	<u>\$ 200,085</u>	<u>\$ -</u>	<u>\$ 24,688,430</u>

See notes to financial statements.

DIRECT RELIEF INTERNATIONAL
(A NON-PROFIT CORPORATION)
STATEMENT OF ACTIVITIES
FOR THE THREE MONTHS ENDED MARCH 31, 2004

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total All Funds March 31, 2004</u>
Public support and revenue				
Public support:				
Contributions:				
In cash and securities	\$ 535,075	\$ 10,504	\$ -	\$ 545,579
In-kind - pharmaceutical and medical supplies	12,817,333			12,817,333
In-kind - nonmedical				-
Contributed freight	73,449			73,449
Freight subsidy	24,783			24,783
Volunteer services	12,494			12,494
Combined federal campaign contributions	12,180			12,180
Grants	22,500	65,000		87,500
Fundraising events	21,610			21,610
Net assets released from restriction	32,186	(32,186)		-
Total public support	<u>13,551,610</u>	<u>43,318</u>	<u>-</u>	<u>13,594,928</u>
Revenue:				
Investment income	5,559			5,559
Gain (loss) on sale of investments	1,313			1,313
Change in value - split interest agreements	-			-
Unrealized gain (loss) on investments	160,744			160,744
Other income (loss)	13,276			13,276
Total revenue	<u>180,892</u>	<u>-</u>	<u>-</u>	<u>180,892</u>
Total public support and revenue	13,732,502	43,318	-	13,775,820
Expenses				
Program services:				
Medical supplies and related expenses	15,039,558			15,039,558
Supporting services:				
Fundraising	132,632			132,632
Administration	124,966			124,966
Total supporting services	<u>257,598</u>	<u>-</u>	<u>-</u>	<u>257,598</u>
Total expenses	<u>15,297,156</u>	<u>-</u>	<u>-</u>	<u>15,297,156</u>
Increase (decrease) in net assets	<u>\$ (1,564,654)</u>	<u>\$ 43,318</u>	<u>\$ -</u>	<u>\$ (1,521,336)</u>

See notes to financial statements.

**DIRECT RELIEF INTERNATIONAL
(A NON-PROFIT CORPORATION)
STATEMENTS OF CHANGES IN NET ASSETS
FOR THE THREE MONTHS ENDED MARCH 31, 2004**

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Balance at December 31, 2003	\$ 24,217,294	\$ 123,221	\$ -	\$ 24,340,515
Increase/(Decrease) in net assets for the three months ended March 31, 2004	(1,564,654)	43,318		(1,521,336)
Balance at March 31, 2004	<u>\$ 22,652,640</u>	<u>\$ 166,539</u>	<u>\$ -</u>	<u>\$ 22,819,179</u>

See notes to financial statements.

**DIRECT RELIEF INTERNATIONAL
(A NON-PROFIT CORPORATION)
STATEMENT OF FUNCTIONAL EXPENSES
FOR THE THREE MONTHS ENDED MARCH 31, 2004**

	Program Services		Supporting Services		Total Program and Supporting Services March 31, 2004
	Domestic	International	Administration	Fundraising	
Contributed services	\$ -	\$ 12,494	\$ -	\$ -	\$ 12,494
Salaries	18,016	211,405	66,514	52,676	348,611
Payroll taxes	1,861	21,841	6,973	5,573	36,248
Employee benefits	3,576	41,958	9,235	5,289	60,058
Total Salaries and Related Expenses	23,453	287,698	82,722	63,538	457,411
Pharmaceuticals, medical equipment and supplies distributed	471,158	13,913,309	-	-	14,384,467
Accounting and legal	24	713	9,214	117	10,068
Advertising	-	-	10,050	1,347	11,397
Bank charges and brokerage fees	1	29	2,593	-	2,623
Contract services	813	1,251	1,522	2,500	6,086
Contributed freight expense	-	73,449	-	-	73,449
Development education	24	698	-	1,122	1,844
Dues and subscriptions	133	3,916	505	340	4,894
Duplicating and printing	66	1,934	776	1,371	4,147
Equipment parts and refurbishment	66	1,942	-	-	2,008
Freight and processing charges	4,244	124,773	370	370	129,757
Grants and stipends	-	14,569	-	-	14,569
Hospitality	23	667	1,743	-	2,433
Insurance	206	6,042	137	112	6,497
Interest	669	19,659	450	368	21,146
Office supplies	203	5,974	4,173	1,341	11,691
Packing supplies	35	1,018	-	-	1,053
Postage and mailing services	29	851	279	603	1,762
Procurement	6,540	24,176	-	-	30,716
Public relations	-	-	12,125	-	12,125
Repairs and maintenance	170	5,002	1,287	1,781	8,240
Seminars	14	416	35	2,980	3,445
Special events	-	-	-	45,070	45,070
Taxes, licenses and fees	13	383	2,004	-	2,400
Travel and auto expenses	452	13,296	73	291	14,112
Utilities and telephone	282	8,293	1,091	357	10,023
Warehouse operations	24	701	-	-	725
Total Expenses Before Depreciation	508,642	14,510,759	131,149	123,608	15,274,158
Depreciation and amortization	663	19,494	1,483	1,358	22,998
Total Functional Expenses	\$ 509,305	\$ 14,530,253	\$ 132,632	\$ 124,966	\$ 15,297,156

See notes to financial statements.

**DIRECT RELIEF INTERNATIONAL
(A NON-PROFIT CORPORATION)
STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED MARCH 31, 2004**

	Total All Funds March 31, 2004
Cash flows from operating activities:	
Increase (decrease) in net assets	\$ (1,521,336)
Adjustments to reconcile changes in net assets to net cash provided by operating activities:	
(Increase)/Decrease in inventory	1,567,135
Depreciation and amortization	22,998
Realized (gain) loss on sale of investments	(1,345)
Unrealized (gain) loss on investments	(160,744)
Changes in operating assets and liabilities:	
Contributions receivable	397,578
Prepaid expenses	(6,934)
Accounts payable	30,439
Accrued expenses	10,875
Other liabilities	(39,073)
Net cash provided by operating activities	299,593
Cash flows from investing activities:	
Purchases of property and equipment	(42,069)
Proceeds from sales and maturities of investments	702,082
Purchases of investments	(1,201,508)
Investment in split interest agreements	(3,247)
Net cash used by investing activities	(544,742)
Cash flows from financing activities:	
Principal reduction on first and second trust deeds	(11,330)
Net cash used by financing activities	(11,330)
Net increase/(decrease) in cash and cash equivalents	(256,479)
Cash and cash equivalents - beginning of period	\$ 891,247
Cash and cash equivalents - end of period	\$ 634,768

See notes to financial statements

Note 1: Summary of Significant Accounting Policies

Change in Fiscal Year

In 2003, the Board of Directors of Direct Relief International (the Organization) approved changing the Organization's fiscal year from a December 31 year end to a March 31 year end. An interim, or "short", fiscal year is required to bridge the old and new twelve month reporting periods. Direct Relief's short fiscal year began January 1, 2004 and ended March 31, 2004. That short year is the subject of these financial statements.

Organization

Direct Relief International (the Organization), a California non-profit public benefit corporation, provides pharmaceuticals, medical supplies, equipment and services to medically less developed areas around the world as well as medical assistance to victims of natural and man-made disasters.

Financial Statement Presentation

In 1995, the Organization adopted Statement of Financial Accounting Standards (SFAS) No.117, "Financial Statements of Not-for-Profit Organizations". SFAS No. 117 requires the Organization to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets and permanently restricted net assets. In addition, the Organization is required to present a statement of cash flows.

Contributions

The Organization also adopted SFAS No. 116, "Accounting for Contributions Received and Contributions Made" in 1995. In accordance with SFAS No. 116, contributions received are recorded as unrestricted, temporarily restricted or permanently restricted support depending on the existence or nature of any donor restrictions.

During the three months ending March 31, 2004, the Organization received \$43,318 in restricted donations for domestic and international programs which had not been spent by March 31, 2004. These amounts have been classified as temporarily restricted net assets.

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions

that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Promises To Give (Pledges)

Contributions are recognized when the donor makes a promise to give to the Organization that is, in substance, unconditional. Contributions that are restricted by the donor are reported as increases in unrestricted net assets if the restrictions expire in the fiscal year in which the contributions are recognized. All other donor-restricted contributions are reported as increases in temporarily restricted net assets depending on the nature of the restrictions. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets. The Organization uses the allowance method to determine uncollectible unconditional promises receivable.

Inventory and In-kind Medical Contributions Received

Contributions of pharmaceutical and medical supplies are recorded at estimated wholesale value on the date received, based on published wholesale price indexes for pharmaceuticals and medical supplies. Contributions of medical equipment are recorded at estimated wholesale value based upon wholesale price guides or, when necessary, judgmentally determined.

Property and Equipment

Property and equipment are recorded at cost and depreciated using the straight-line method over their useful lives of five to forty years.

Investments

In 1996, the Organization adopted SFAS No. 124, "Accounting for Certain Investments Held by Not-for-Profit Organizations". Under SFAS No. 124, investments in marketable securities with readily determinable fair values and all investments in debt securities are reported at their fair values in the statement of financial position. Unrealized gains and losses are included in the change in net assets.

Income Taxes

The Organization is a not-for-profit organization that is exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code.

Valuation of Future Interests

The Organization serves as trustee of a unitrust, of which it is the charitable beneficiary. The Organization is also the beneficiary of several charitable gift annuities. The future interests in the trust and in the gift annuities are recorded as assets and valued at fair market value on the date of each gift. Investments in the

trust and in the gift annuities are adjusted to market value at the end of each year. The present value of the total estimated future distributions to the donors on the date of each gift is recorded as a liability.

Cash and Cash Equivalents

For purposes of the statement of cash flows, the Organization considers all highly liquid investments with an initial maturity of three months or less to be cash equivalents.

Note 2: Supplemental Cash Flow Disclosures

The Organization paid interest of \$21,146 for the three months ended March 31, 2004.

Note 3: Investments

The Organization has adopted SFAS No. 124, "Accounting for Certain Investments Held by Not-for-Profit Organizations". This statement requires that nonprofit organizations record investments at fair market value in the statements of financial position. Investment holdings as of March 31, 2004 are composed of the following:

	<i>Cost</i>	<i>Market</i>
Mutual funds	\$ 3,273,031	\$ 3,993,713
Partnership interest	700,000	722,080
Government bonds	2,500	2,492
Total investments	\$ 3,975,531	\$ 4,718,285

Note 4: Property and Equipment

Property and equipment consist of the following at:

	March 31, 2004
Office and Warehouse	\$ 1,827,186
Land	1,363,950
Warehouse equipment	101,757
Computer equipment	91,268
Office equipment	73,361
Furniture & fixtures	65,163
Delivery equipment	61,653
Computer software	57,295
Bio-med equipment	43,007
Total	3,684,640
Less: Accumulated Depreciation	-610,744
Net Property and Equipment	<u>\$ 3,073,896</u>

Note 5: Split Interest Agreements

The Organization held interests in the following agreements:

Agreement 1: The Organization holds a 25% interest in a charitable remainder unitrust established in 1991. The trust has a 20 year life and is composed of assets valued at \$415,023. The Organization's interest as of March 31, 2004 is valued at \$31,375, calculated by using an 8% discount rate over the remaining fifteen year term of the trust.

Agreement 2: The Organization holds a 12.5% interest in a charitable remainder trust established in 1980. The trust terminates upon the death of the income beneficiary. The Organization's interest as of March 31, 2004 is valued at \$9,798, calculated by using an 8% discount rate over the estimated life expectancy (seventeen years) of the income beneficiary.

Agreement 3: The Organization is the sole beneficiary of several gift annuities established in 1993 and 1994. The annuities are held in trust. The assets of the trust are valued at \$23,059 (fair market value) as of March 31, 2004. A corresponding liability of \$15,948 is calculated by discounting at 6% the present value of estimated future distributions to the annuitants.

Agreement 4: The Organization is the sole beneficiary of a charitable remainder unitrust created in 1980. The terms of the trust require annual distributions of 5% of the corpus of the trust for the lifetime of the grantor and a successor beneficiary. As of March 31, 2004, the trust had assets valued at \$43,850 with a corresponding liability of \$20,845.

The Organization is trustee for Agreements 3 and 4; the assets are held in separate accounts and are not commingled with other Organization assets. The remaining Agreements are held in trust by third parties.

Note 6: Debt

The Organization's long-term debt consists of the following at:

	<u>March 31, 2004</u>
Mortgage note payable, requiring monthly payments of \$ 7,604 including interest at 5.50%, maturing on October 1, 2007	\$ 1,151,443
Mortgage note payable, requiring monthly payments of \$ 3,222 including interest at 4.50%, maturing on November 1, 2007	463,696
Total long-term debt	\$ 1,615,139
Less: current portion	46,793
Long-term portion	<u>\$ 1,568,346</u>

The mortgage notes are secured by the Organization's warehouse facility. The following is a summary of principal maturities of long-term debt during the next five years:

2005	\$ 46,793
2006	49,243
2007	51,821
2008	<u>1,467,282</u>
Total	<u>\$ 1,615,139</u>

Note 7: Quasi-endowment fund

In 1998, the Organization established a board designated endowment fund. The purpose of the fund was to provide a reserve for future operations. The endowment's resources came from board designated unrestricted gifts and donations in excess of operational needs.

During the three months ended March 31, 2004, the fund generated \$4,736 in investment income and \$160,506 in unrealized appreciation on its securities and investment portfolio. Total net assets of the Endowment are \$5,011,156 as of March 31, 2004.

Note 8: Contributed Freight

Contributed freight of \$73,449 for the three months ended March 31, 2004, represents estimated shipping expenses incurred by other organizations on behalf of Direct Relief International in the shipment of medical supplies to foreign countries.

Note 9: Contributed Services

The Organization records the estimated value of professional services performed by volunteers that are an integral part of its operations. The estimated value of volunteer services is as follows:

	March 31, 2004
Bio-Medical equipment repairs	<u>\$ 5,740</u>
Other medical services	<u>6,754</u>
Total Contributed Services	<u>\$ 12,494</u>

In addition to the above, the Organization received 1,492 hours of volunteer services of a non-professional, non-technical nature.

Note 10: Pension Expense

The Organization has an employee participation pension plan. Employee contributions to the plan are matched by the Organization, up to a maximum of 5% of the employee's annual gross salary. The pension expense associated with the plan for the three months ended March 31, 2004 was \$10,529. All employees working at least 1,000 hours per year are eligible for matching contributions.

Note 11: Non-Qualified Deferred Compensation Agreement

The Organization is party to a non-qualified deferred compensation agreement with the surviving spouse of a co-founder of the Organization. Under the terms of the agreement, beginning January 1, 1971, the Organization is obligated to make monthly payments in acknowledgement of his 23 years of service. The retirement agreement expense for the three months ended March 31, 2004 was \$2,480.

Note 12: Fair Value Of Financial Instruments

The Organization has a number of financial instruments, none of which are held for trading purposes. The Organization estimates that the fair value of all financial instruments at March 31, 2004 does not differ materially from the aggregate carrying values of its financial instruments recorded in the accompanying statement of financial position. The estimated fair value amounts have been determined by the Organization using available market information and appropriate valuation methodologies. Considerable judgment is necessarily required in interpreting market data to develop estimates of fair value, and, accordingly, the estimates are not necessarily indicative of the amounts that the Organization could realize in a current market exchange.

Note 13: Concentrations of Credit Risk

Financial instruments that potentially subject the Organization to concentrations of credit risk consist principally of bank and brokerage deposits. The Organization places its temporary cash investments with financial institutions and brokerages. For the three months ended March 31, 2004, the Organization was at risk for \$96,575 in cash deposited at individual financial institutions. The Federal Deposit Insurance Corporation (FDIC) insures individual deposits up to \$ 100,000. In addition, the Organization's investments are exposed to various risks, such as interest rate fluctuations and market valuations. Due to the level of risk associated with certain investment securities and the level of uncertainty related to changes in the value of investment securities, it is at least reasonably possible that changes in risks in the near term could materially effect the Organization's statement of financial position and the statement of activities.