

PACIFIC BATTLESHIP CENTER

Financial Statements
December 31, 2016 and 2015
(With Independent Auditor's Report Thereon)

PACIFIC BATTLESHIP CENTER

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Independent Auditor's Report

The Board of Directors
Pacific Battleship Center
San Pedro, California

We have audited the accompanying financial statements of the Pacific Battleship Center (a nonprofit organization), which comprise the statement of financial position as of December 31, 2016, and the related statements of activities 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.

Auditor's 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 of 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 2016 financial statements referred to above present fairly, in all material respects, the financial position of the Pacific Battleship Center as of December 31, 2016, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Prior Period Financial Statements

The financial statements of the Pacific Battleship Center as of December 31, 2015, were audited by other auditors whose report dated June 24, 2016, expressed an unmodified opinion on those statements.

Macias Consulting Group, Inc.

June 30, 2017
Sacramento, California

Pacific Battleship Center
Statements of Financial Position
December 31, 2016 and 2015

Assets	2016	2015
Cash	\$ 604,642	\$ 655,771
Accounts receivable	80,912	64,874
Contributions receivable	555,000	518,540
Engineering/machine shop materials	64,446	50,038
Deposits and prepaid insurance	77,075	74,662
Property and equipment, net	<u>4,256,307</u>	<u>4,268,285</u>
Total assets	<u><u>\$ 5,638,382</u></u>	<u><u>\$ 5,632,170</u></u>
Liabilities and Net Assets		
Liabilities:		
Accounts payable	\$ 294,307	\$ 105,265
Accrued and other liabilities	249,831	163,488
Unearned revenue	59,119	61,193
Line of credit	-	175,000
Capital lease obligation	-	2,808
Loan and notes payable	<u>1,021,026</u>	<u>1,198,030</u>
Total liabilities	<u>1,624,283</u>	<u>1,705,784</u>
Net Assets:		
Unrestricted	2,995,629	3,026,902
Temporarily restricted	<u>1,018,470</u>	<u>899,484</u>
Total net assets	<u>4,014,099</u>	<u>3,926,386</u>
Total liabilities and net assets	<u><u>\$ 5,638,382</u></u>	<u><u>\$ 5,632,170</u></u>

See accompanying notes to financial statements.

Pacific Battleship Center
Statement of Activities
Year ended December 31, 2016

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Total</u>
Revenues and other support:			
Admissions	\$ 2,413,227	\$ -	\$ 2,413,227
Contributions	1,043,453	624,150	1,667,603
Donated goods and services	476,775	-	476,775
Commissions	217,182	-	217,182
Other income	126,544	-	126,544
Total revenues	<u>4,277,181</u>	<u>624,150</u>	<u>4,901,331</u>
Net assets released from restriction	<u>505,164</u>	<u>(505,164)</u>	<u>-</u>
Total revenues and other support	<u>4,782,345</u>	<u>118,986</u>	<u>4,901,331</u>
Expenses:			
Program services (including \$240,820 of donated goods and services)	2,909,881	-	2,909,881
General and administrative	651,482	-	651,482
Fundraising	614,916	-	614,916
Subtotal expenses	<u>4,176,279</u>	<u>-</u>	<u>4,176,279</u>
Change in net assets, before depreciation	606,066	118,986	725,052
Depreciation	<u>(637,339)</u>	<u>-</u>	<u>(637,339)</u>
Change in net assets	(31,273)	118,986	87,713
Net assets, beginning of year	<u>3,026,902</u>	<u>899,484</u>	<u>3,926,386</u>
Net assets, end of year	<u>\$ 2,995,629</u>	<u>\$ 1,018,470</u>	<u>\$ 4,014,099</u>

See accompanying notes to financial statements.

Pacific Battleship Center
Statement of Activities
Year ended December 31, 2015

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Total</u>
Revenues and other support:			
Admissions	\$ 2,444,218	\$ -	\$ 2,444,218
Contributions	204,063	355,264	559,327
Donated goods and services	226,624	-	226,624
Commissions	218,359	-	218,359
Other income	210,378	-	210,378
Total revenues	<u>3,303,642</u>	<u>355,264</u>	<u>3,658,906</u>
Net assets released from restriction	412,246	(412,246)	-
Total revenues and other support	<u>3,715,888</u>	<u>(56,982)</u>	<u>3,658,906</u>
Expenses:			
Program services (including \$202,624 of donated services)	2,643,659	-	2,643,659
General and administrative	626,478	-	626,478
Fundraising	140,116	-	140,116
Subtotal expenses	<u>3,410,253</u>	<u>-</u>	<u>3,410,253</u>
Change in net assets, before depreciation	305,635	(56,982)	248,653
Depreciation	(580,406)	-	(580,406)
Change in net assets	(274,771)	(56,982)	(331,753)
Net assets, beginning of year	<u>3,301,673</u>	<u>956,466</u>	<u>4,258,139</u>
Net assets, end of year	<u>\$ 3,026,902</u>	<u>\$ 899,484</u>	<u>\$ 3,926,386</u>

See accompanying notes to financial statements.

Pacific Battleship Center
Statements of Cash Flows
Years ended December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Cash flows provided by operating activities:		
Change in net assets	\$ 87,713	\$ (331,753)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	637,339	580,406
Contributed property and equipment	(182,100)	(2,000)
Change in assets and liabilities:		
Accounts receivable	(16,038)	(17,860)
Contributions receivable	(36,460)	248,960
Engineering/machine shop materials	(14,408)	480
Deposits and prepaid insurance	(2,413)	(5,251)
Accounts payable	189,042	(76,957)
Accrued and other liabilities	86,343	(57,344)
Unearned revenue	(2,074)	54,343
Cash provided by operating activities	<u>746,944</u>	<u>393,024</u>
Cash flows from investing activity:		
Purchases of property and equipment	<u>(443,261)</u>	<u>(199,880)</u>
Cash used in investing activity	<u>(443,261)</u>	<u>(199,880)</u>
Cash flows from financing activities:		
Proceeds from issuance of line of credit	70,000	320,000
Principal repayments on line of credit	(245,000)	(225,000)
Proceeds from issuance of notes payable	180,000	-
Principal repayments on notes payable	(357,004)	(167,560)
Payments on capital lease obligations	<u>(2,808)</u>	<u>(29,280)</u>
Cash used in financing activities	<u>(354,812)</u>	<u>(101,840)</u>
Net increase in cash	(51,129)	91,304
Cash, beginning of year	<u>655,771</u>	<u>564,467</u>
Cash, end of year	<u><u>604,642</u></u>	<u><u>655,771</u></u>
Supplemental disclosure of cash flow information:		
Cash paid during the year for interest	\$ 38,476	\$ 35,688
Non-cash investing activity:		
Contributed property and equipment	\$ 182,100	\$ 2,000

See accompanying notes to financial statements.

PACIFIC BATTLESHIP CENTER

Notes to Financial Statements

December 31, 2016 and 2015

(1) Organization

The Pacific Battleship Center (PBC or Organization) is a California not-for-profit corporation, with a mission to:

- celebrate the American spirit through the preservation and interpretation of the Battleship USS Iowa,
- educate the public on the accomplishments and sacrifices of American patriots, and
- engage guests in unique and exciting ways that bring the ship to life by connecting the past with the future.

The PBC accomplishes this through the operation of a museum of naval history aboard the former Battleship USS Iowa (BB-61), which is moored in the Port of Los Angeles. Following ship restoration and pre-opening preparation, the ship was opened to the public in July 2012.

The PBC leases from the City of Los Angeles, through its Board of Harbor Commissioners, the pier where the USS Iowa is moored. In accordance with accounting principles generally accepted in the United States of America, the fair value of the use of the pier in excess of the amounts paid is to be reflected on the Organization's financial statements. Since no objective basis is available to determine the fair value of the use of the pier, no amounts have been reported in the financial statements for the use of the pier.

The United States Navy has allowed PBC to use the USS Iowa as a maritime museum. In accordance with accounting principles generally accepted in the United States of America, the fair value of the use of the USS Iowa is to be reflected on the PBC's financial statements. However, since no objective basis is available to measure the related value, no amounts have been recorded in the financial statements for the use of the ship.

(2) Summary of Significant Accounting Policies

(a) Basis of presentation

The financial statements are prepared on the accrual basis of accounting in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 958, *Presentation of Financial Statements – Not-for-Profit Entities*. The assets, liabilities, and net assets of the PBC are reported within categories as follows:

Unrestricted net assets – Net assets not subject to donor imposed stipulations.

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Notes to Financial Statements (Continued)
December 31, 2016 and 2015

Temporarily restricted net assets – Net assets subject to donor imposed stipulations that will be met by actions of the PBC and/or the passage of time. When a donor stipulated time restriction ends or a purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the accompanying statements of activities as net assets released from restriction.

Permanently restricted net assets – Net assets subject to donor imposed stipulations requiring that they be maintained permanently by the PBC. The income from these assets is available for either general operations or specific programs as specified by the donor. The PBC did not have any permanently restricted net assets as of December 31, 2016 or 2015.

Revenues are reported as increases in unrestricted net assets unless use of the related assets is limited by donor imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation or by law. Expirations of temporary restrictions on net assets (i.e., the donor stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) are reported as reclassifications between the applicable classes of net assets.

(b) Cash

The PBC considers all highly liquid instruments purchased with an original maturity of three months or less to be cash and cash equivalents. The PBC maintains its cash in one financial institution. The accounts maintained in the institution are guaranteed by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000. The PBC's cash balance exceeded FDIC limits by \$370,857 at December 31, 2016. The PBC has not experienced any losses on these accounts and does not believe it is exposed to any significant risk.

(c) Contributions receivable

Unconditional promises to give are recorded as contributions receivable. The PBC discounts contributions that are expected to be collected after one year at a rate commensurate with the risk involved. Amortization of the discount is recorded as additional contribution revenue.

(d) Engineering/machine shop materials

When the PBC took possession of the USS Iowa, it contained excess quantities of various metals, such as aluminum, brass and steel. It is anticipated these materials will be consumed in the repair and maintenance of the ship. The fair value is estimated based on current retail prices, and has been recorded as engineering/machine shop materials in the accompanying financial statements.

In addition, the ship included wooden decking, the majority of which consisted of teak wood. However, unlike the metals, this wood is not in excess of the ship's needs, and has not been recorded in the accompanying financial statements.

PACIFIC BATTLESHIP CENTER
Notes to Financial Statements (Continued)
December 31, 2016 and 2015

(e) *Deposits and prepaid insurance*

The PBC has entered into a financing arrangement for annual insurance premiums. After the down payment paid during 2016, the PBC has an obligation to pay \$41,608 as of December 31, 2016 and is reflected as accrued and other liabilities in the accompanying financial statements. The financed asset amounts as of December 31, 2016 of \$51,775 is included in deposits and prepaid insurance in the accompanying financial statements, and will be amortized over the next year.

(f) *Property and equipment*

Property and equipment are carried at cost at date of purchase or fair value at date of donation, net of accumulated depreciation.

Depreciation is provided using the straight-line method over the estimated useful lives of the assets. Ship restoration and improvements and furniture and equipment are depreciated over 10 years. The costs of normal maintenance and repairs and minor replacements are charged to expense when incurred.

(g) *Fair value of financial instruments*

The carrying amounts of cash, accounts and contribution receivable, accounts payable, accrued and other liabilities, unearned revenue, line of credit, capital lease obligation, and loan and notes payable at December 31, 2016 and 2015, approximate fair value because of the short term maturity of these financial instruments.

(h) *Commissions*

The PBC generates commission revenue from the operation of its gift shop and its photo booth. The PBC also generates smaller amounts of commission revenue from event catering, food concessions, soft drink machines and ATM machines.

(i) *Tax exempt status*

The PBC is tax exempt under Section 501(c)(3) of the Internal Revenue Code and Section 23701d of the Revenue and Taxation Code of the State of California and, generally, is subject to state and federal income taxes on any net income that is derived from a trade or business, regularly carried on, and not in furtherance of the purpose for which the PBC was granted exemption. Management recorded an income tax provision for the years ended December 31, 2016 and 2015 of approximately \$0 and \$10,370, respectively.

The PBC has evaluated the financial statement impact of tax positions taken or expected to be taken in its tax returns. The PBC has reviewed its positions for all open tax years and has determined that no additional provision for income taxes is required. The PBC is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress.

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Notes to Financial Statements (Continued)
December 31, 2016 and 2015

(j) Donated goods and services

In 2016 and 2015, the PBC received donated goods and services of \$476,775 and \$226,624, respectively, which are reflected in the accompanying statements of activities at their estimated fair values at the date of receipt as donated goods and services revenue. Contributions of services are recognized if the services create or enhance nonfinancial assets or require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation. Donated goods and services received for the years ended December 31, 2016 and 2015 are as follows:

	2016	2015
Donated program services	\$ 239,763	\$ 197,669
Debt forgiveness	21,379	22,000
Donated goods	1,057	4,955
Capitalized equipment	214,576	2,000
Total donated goods and services	\$ 476,775	\$ 226,624

The PBC also has community volunteers that provide their services through oversight and hands-on participation in the PBC's activities. Such contributed services have not been recognized in the accompanying financial statements as they do not require specialized skills.

(k) Membership Revenue

The PBC receives membership dues and considers the memberships exchange transactions. As exchange transactions, the membership dues are deferred and amortized over the lives of the memberships.

(l) Advertising

The PBC uses advertising to promote its programs among the audiences it serves. All advertising costs are expensed as incurred. Total advertising costs for the years ended December 31, 2016 and 2015 were \$362,610 and \$268,421, respectively.

(m) Functional allocation of expenses

The costs for providing various program services, general administrative services, and fundraising expenses, excluding depreciation, have been summarized on a functional basis in the statements of activities. Program related and fundraising expenses are tracked on a time entry system and reviewed and allocated regularly, and those costs not directly associated with program services or fundraising are allocated to general administration

PACIFIC BATTLESHIP CENTER
Notes to Financial Statements (Continued)
December 31, 2016 and 2015

expenses. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

(n) Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

(o) Reclassifications

Certain reclassifications have been made to the 2015 financial statement presentation to conform to the current year presentation.

(3) Property and equipment

Property and equipment are summarized as follows at December 31, 2016 and 2015:

	<u>2016</u>	<u>2015</u>
Furniture and equipment	\$ 2,756,172	\$ 2,130,811
Sewer installation	254,625	254,625
Ship restoration and improvement	<u>3,679,387</u>	<u>3,679,387</u>
Subtotal capital assets	6,690,184	6,064,823
Accumulated depreciation	<u>(2,433,877)</u>	<u>(1,796,538)</u>
Total property and equipment, net	<u>\$ 4,256,307</u>	<u>\$ 4,268,285</u>

Depreciation expense was \$637,339 and \$580,406 for the years ended December 31, 2016 and 2015, respectively.

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Notes to Financial Statements (Continued)
December 31, 2016 and 2015

(4) Contributions receivable

Contributions receivable at December 31, 2016 and 2015, respectively, are expected to be received as follows:

	<u>2016</u>	<u>2015</u>
Within one year	\$ 401,000	\$ 262,000
Within one to five years	<u>154,000</u>	<u>256,540</u>
Total contributions receivable	<u>\$ 555,000</u>	<u>\$ 518,540</u>

The amounts due from one donor represent 45% and 97% of the contributions receivable at December 31, 2016 and 2015, respectively.

(5) Capital lease obligation

The PBC operates a ticketing booth under a capital lease, with a principal balance due of \$2,808 at December 31, 2015, which was fully paid off during the year ended December 31, 2016.

(6) Commitments

(a) The PBC leases the pier where the USS Iowa is moored from the City of Los Angeles, through its Board of Harbor Commissioners. The PBC leases the pier under an agreement that requires PBC to pay monthly rent based on the greater of a) a fixed-minimum monthly rental, or b) an amount equal to a percentage of admission, commission and other income arising from any business, use or operation occurring on the premises. The lease contains two 5-year renewal options after the original lease period expires. The first of the 5-year renewals was successfully completed in June 2017. The PBC also leases office equipment under operating leases with varying expirations.

Minimum future rental payments under the non-cancellable operating leases are as follows:

<u>Years Ending December 31,</u>	<u>Amount</u>
2017	\$ 100,000
2018	100,000
2019	100,000
2020	100,000
2021	100,000
Thereafter	<u>100,000</u>
	<u>\$ 600,000</u>

PACIFIC BATTLESHIP CENTER
Notes to Financial Statements (Continued)
December 31, 2016 and 2015

Rent expense was approximately \$111,661 and \$118,000 for the years ended December 31, 2016 and 2015, respectively.

(b) In 2013, the PBC entered into a contractual agreement with a former employee to provide consulting services to the PBC until August 31, 2017. Management believes that the contract includes substantial risk of forfeiture and therefore only payments of approximately \$108,300 made in 2016 and 2015, respectively, are reflected as expenses in the accompanying financial statements.

(7) Line of credit

During 2014, the PBC obtained a \$250,000 revolving line of credit from Farmers & Merchants Bank to help finance its working capital and short-term capital needs. The unsecured line of credit was increased in 2015 to \$325,000 and renewed with an expiration date of October 29, 2016. The unsecured line of credit was reduced to \$300,000 and renewed with an expiration date of October 29, 2018. The line of credit had a balance of \$0 and \$175,000 at December 31, 2016 and 2015, respectively. Interest is payable monthly on outstanding balances at the interest rate of 6%.

(8) Loan and notes payable

At December 31, 2012, the PBC had approximately \$1.2 million of accounts payable representing pre-opening amounts, i.e., amounts arising from activities prior to the opening of the USS Iowa to the public. During 2013, the PBC negotiated the settlement of these amounts with various vendors, which resulted in \$728,279 converted to long-term notes payable and \$259,223 of debt forgiveness, the latter represented as a contribution in 2013. In each of 2016 and 2015, an additional \$10,000 was forgiven, and is included in donated goods and services in the accompanying financial statements, respectively.

PACIFIC BATTLESHIP CENTER
Notes to Financial Statements (Continued)
December 31, 2016 and 2015

At December 31, 2016 and 2015, respectively, loan and notes payable consist of the following:

	<u>2016</u>	<u>2015</u>
Non-interest bearing loan due to a related party, payable monthly with outstanding principal due in 2021.	\$ 488,625	\$ 500,000
Note due to a related party with annual interest rate of 4.0%, with outstanding principal due in January 2019. The PBC recorded \$8,667 and \$12,000 of forgiven interest as donated goods and services in 2016 and 2015, respectively, in the accompanying statements of activities.	100,000	300,000
Note bearing interest rate of 4.0% annually, due upon demand.	50,000	50,000
Notes payable as settlement for pre-opening payables, with annual interest rate of 4.0%, payable monthly with outstanding principal and interest due in 2016.	-	29,533
Notes payable as settlement for pre-opening payables, with annual interest rate of 4.0%, payable monthly with outstanding principal and interest due in 2017.	9,212	25,004
Notes payable as settlement for pre-opening payables, with annual imputed interest rate of 4.0%, payable monthly with outstanding principal and interest due in 2018.	121,388	189,434
Notes payable as settlement for pre-opening payables, with an annual interest rate of 4.0%, payable monthly with outstanding principal and interest due in 2019.	73,538	104,059
Note payable, bank, for costs related to installation of shore power, with annual interest rate of 6.0%, payable monthly with outstanding principal and interest due in 2023.	178,263	-
Total loan and notes payable	<u>\$ 1,021,026</u>	<u>\$ 1,198,030</u>

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Notes to Financial Statements (Continued)
December 31, 2016 and 2015

Future principal payments due at December 31 are as follows:

Years Ending December 31,	Amount
2017	\$ 324,759
2018	188,651
2019	154,910
2020	157,638
2021	137,961
Thereafter	57,107
	\$ 1,021,026

9) Functional allocation of expenses

For the years ended December 31, 2016 and 2015, expenses by functional basis (inclusive of depreciation) are as follows:

	2016	2015
Program services	\$ 3,547,220	\$ 3,224,065
General and administrative	651,482	626,478
Fundraising	614,916	140,116
Total expenses by functional basis	\$ 4,813,618	\$ 3,990,659

(10) Subsequent events

The PBC has evaluated subsequent events from the date of the statement of financial position through June 30, 2017, which is the date the financial statements were available to be issued.

In late 2016, the PBC completed construction of shore power facilities to provide electricity to the ship, and eliminate reliance on generator-based power and emission of pollutants into the environment. The related construction loan used to finance the cost of this project was converted into a multi-year term loan, as described previously in Note 8.

In Spring 2017, the PBC began work on its hull preservation project, which will be funded by a \$500,000 grant from the State of Iowa. This will allow the PBC to indefinitely defer the significantly more-costly process of dry-docking the ship for repairs in future years. The grant requires the PBC to submit invoices to the State of Iowa for reimbursement. In order to provide cash flow for the time between payments to vendors and receipt of the grant reimbursement, the

PACIFIC BATTLESHIP CENTER
Notes to Financial Statements (Continued)
December 31, 2016 and 2015

PBC obtained a \$250,000 line of credit, expiring in October 2018. As of June 30, 2017, the balance outstanding on the line of credit was \$58,021.

Also in Spring 2017, the PBC introduced the first component of its Battleship Aviation project when it unveiled a restored Korean War-era Piasecki HUP 2 helicopter, one of the last two of its kind available in the United States. The addition of the HUP 2 helicopter will help share the story of the evolution of battleship aviation and expand the narrative of the ship's involvement in the Korean War.